South Carolina Legislative Audit Council

LAC

Report to the General Assembly

July 1995

A Management and Performance Review of the South Carolina Jobs-Economic Development Authority

LAC/JEDA-93-2

Legislative Audit Council

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A Management and Performance Review of the South Carolina Jobs-Economic Development Authority was conducted by the following audit team.

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Executive Summary

Members of the General Assembly requested that we conduct a management and performance audit encompassing all of the South Carolina Jobs-Economic Development Authority (JEDA), its programs, activities, and affiliated corporations. JEDA was established in 1983 and as of October 31, 1994, had made 220 direct loans and guarantees totalling $56.6 million and had issued 88 bonds totaling $447 million. Most loans were made with federal community development block grant (CDBG) funds and with state funds appropriated to capitalize a revolving loan fund for JEDA's corporation—Carolina Capital Investment Corporation (CCIC).

The number of jobs created and retained by JEDA's client businesses is an important measure of the success of its programs, as is the percent of private funds invested along with JEDA's loans (leveraged).

JEDA significantly overstated job creation/retention figures in its annual report to the General Assembly and the Governor.

- JEDA significantly overstated job creation/retention figures in its annual report to the General Assembly and the Governor. JEDA counts jobs from loans to businesses which have gone into default and/or bankruptcy and for which the jobs no longer exist. JEDA also counts the same jobs as created and as retained when it issues more than one loan to a company. It claims credit for retaining jobs when it is questionable whether the jobs would have been lost without government assistance, and claims all jobs when projects are funded jointly with another government agency. JEDA has no written procedures on how jobs should be counted (see p. 7).

JEDA provides "gap financing." It was created to fill gaps in the capital market and to fill the void between what a business needs and what a bank is willing to lend. However, as a manager of public funds, JEDA also must properly safeguard its loans from loss. We reviewed JEDA's loan portfolio to see how loans were made and what amount of loan funds were lost when debts were forgiven or "charged off."

- JEDA allows a *committee* of the Board of Directors, as well as loan officers, to approve loans. This violates JEDA's statutes and by-laws (see p. 12).

- JEDA has charged off 24 CDBG loans as of July 31, 1994; 18 had 90% or more of the original loan amount forgiven. While charge-offs have declined since 1991, we found JEDA increasingly is allowing borrowers to defer loan payments. This may understate future rates of delinquent and defaulted loans. With a charge-off rate of 12.72%, JEDA is higher than other in-state economic development loan programs, whose rates ranged from less than 2% to 7.26% (see p. 12).

JEDA has not collected and analyzed economic development information and has not established a strategic plan with goals and performance measures for its programs. Without these mechanisms, JEDA cannot determine whether its programs are necessary and have been effective in promoting economic development in the state. Measures such as job quality, targeting specific industries, helping historically distressed counties and small businesses, and quality of service are important to JEDA's program outcomes. For example:

- Only 43% of the CDBG loan funds and 7% of the bond financing has actually gone to businesses located in historically distressed counties of the state (see p. 22).

- JEDA says it loans to small businesses but has not developed a definition of small business as required by law (see p. 22).

Our review found that the majority of JEDA's programs have not met key economic development goals. We excluded five programs from review because they had little or no activity. Three programs we reviewed have had limited success. For example:

Our review found that the majority of JEDA's programs has not met key economic development goals set forth in the law.

- The Industrial Development Bond (IDB) Program—67% of the jobs attributed to this program since 1985 were retained; only 33% of all the jobs were created after the companies received bond financing. Eighteen percent of the companies with bonds failed to create jobs, and the average cost per new job was high—$102,425 (see pp. 10, 24).

- The Export Program—Since 1989, JEDA has made only 5 loan guarantees (2 to the same company) and created approximately 17 jobs with its export financing (see p. 28).

- The Palmetto Basic Building Fund—Since 1989, only 15 jobs have been created and only 2 buildings sold (see p. 30).

In our examination of compliance with loan policies and procedures, we found instances where JEDA made loans to borrowers with substantial net worth and did not require adequate collateral or personal guarantees.

- Four cases with inadequate collateral accounted for 22% of the losses incurred in CDBG loan program (see p. 35).

- CCIC does not have a policy limiting the percent of a total project's cost it can fund with its loans. It has leveraged less private investment than JEDA, with only $1.67 in private funds for every public dollar (see p. 40).

- JEDA needs to require that all loan proceeds are appropriately expended and needs to strengthen its conflict of interest policy (see p. 41).

During the course of the audit, we found several problems with financial transactions between JEDA and CCIC. JEDA placed $583,000 in state appropriations in CCIC's revolving loan fund to make loans to businesses. This may be in violation of state law. JEDA should return its FY 94-95 appropriation of $125,000 and use CCIC's fund balance to provide federal matching requirements in place of state appropriations (see p. 45).

We also found that CCIC overcharged JEDA for administrative expenses, which are paid by state and federal appropriations. CCIC recovered from JEDA about $205,000 more than its actual costs for personnel. We also found that JEDA owes CCIC $161,000 in fees for managing another program. JEDA also used an effective administrative cost rate of 29% in charging the Division of Economic Development (DED) for administration of the five loans made in the Minority Loan Program. JEDA also may have overcharged for its administration of the Palmetto Basic Building Fund Program (see p. 46).

We also identified issues for further study including the need to reexamine the state's position relative to capital gaps (see p. 61). Finally, we conclude that there may be no need for JEDA to remain an independent state agency.

Major Recommendation

JEDA currently consists of two employees and a governing board. All its staff and functions were transferred to its corporate affiliate, CCIC, in FY 92-93. JEDA's functions as a state agency are primarily to provide oversight and monitoring of the CDBG loan program, to approve CDBG loans, and to issue industrial development bonds.

Possible restructuring of JEDA is a policy issue that could be considered. As long as oversight of the CDBG loan program and CCIC is provided, and the loan decision process is shielded from political pressure, JEDA can be restructured into the state's lead economic development agency—the Department of Commerce. We base our conclusion on the subsequent findings in this report as well as the following major considerations:

- As part of the Department of Commerce, JEDA's financing programs could be more closely aligned with statewide economic development goals.

- We found a need in general for better oversight of JEDA's programs, particularly the relationship between JEDA and its corporate affiliate CCIC.

- The Division of Economic Development (DED) was formerly part of the Governor's office but is now in the Department of Commerce. DED administers the state's CDBG program. It receives CDBG allocations from HUD and previously made economic development loans as well as grants for infrastructure. DED staff report directly to the secretary of commerce.

- Federal, local, and private institutions, as well as a new state initiative called the "Main Street Investment Program," provide major sources of financing for economic development. While the demand for CDBG-funded loans and tax-exempt industrial bonds continues, there may no longer be a need for a separate state authority like JEDA to administer them.

- Other states such as Georgia, Kentucky, and North Carolina have structured their economic development loan programs in various ways, either at the local level or in agencies such as a Department of Commerce or a Department of Local Government.

> The General Assembly may wish to consider placing JEDA under the South Carolina Department of Commerce.

Introduction and Background

Audit Objectives

Members of the General Assembly asked that the Legislative Audit Council (LAC) conduct a management and performance audit encompassing all of the Jobs-Economic Development Authority (JEDA), its programs and activities and its affiliated corporations. The council completed the evaluation of JEDA's role in the South Carolina Resources Authority Infrastructure Funding Program in October 1994. That report is available free of charge from our office.

The overall objective of this report is to examine other responsibilities of JEDA and its affiliated corporations, primarily the Carolina Capital Investment Corporation (CCIC), in order to evaluate how these programs have fulfilled their role in state economic development. To accomplish this evaluation we were guided by several objectives:

- Examine the relationship of JEDA/CCIC programs with the state target programs for economic development.
- Review JEDA/CCIC lending policies and procedures to determine the adequacy of such procedures in safeguarding limited resources.
- Review loan activity and processing using selected HUD requirements, state statutes, and JEDA/CCIC program policies and goals.
- Examine associated administrative and operations costs.

We reviewed information from 1983 through 1994 encompassing both current and charged-off loans. We did not review in detail loans that were of recent origin with short payment histories. Detailed information on the methodology used in this review is found in the text and also in Appendix A.

Background and History

The Jobs-Economic Development Authority (JEDA) was created by Act 145 of 1983 (the South Carolina Jobs-Economic Development Fund Act). JEDA's purpose under this act is to promote the economic welfare of the state by aiding small to medium size businesses with their financing needs. A primary aim of JEDA is to provide for the creation and retention of jobs. Another goal of JEDA is to encourage (leverage) the investment of private funds. JEDA is to accomplish its mission by providing loans, issuing bonds, and assisting in developing an export market for the goods, products, and services produced within the state. JEDA currently operates a not-for-profit corporation, CCIC.

JEDA is governed by a board of seven directors appointed by the Governor. One director is appointed from each congressional district and one from the state at large, who serves as the chairman. Directors must have experience in the fields of business, commerce, finance, banking, real estate, or foreign trade. At least two directors must have direct lending experience.

JEDA Financing Programs

Both JEDA's and CCIC's loan programs are funded principally by two revolving loan funds, bond issues, and CCIC's line of credit with four South Carolina banks. JEDA provides "gap financing." It was created to fill gaps in the capital market and to fill the void between what a business needs to borrow and what a bank is willing to lend. JEDA is a financing program, not an economic development bank. It does not have resident investment funds from outside private sources and is not subject to banking regulations or oversight from bank regulators. JEDA's programs are funded by the following sources:

- The Community Development Block Grant (CDBG) revolving loan fund, capitalized (initially funded) by United States Department of Housing and Urban Development (HUD) funds, provides loans to eligible participants of the CDBG Loan Program. This program funds the lesser of 40% of a project's cost or up to $25,000 per job for a maximum amount of $500,000. A local government receives the grant and then conveys the loan or guarantee to the businesses.

- The CCIC revolving loan fund, capitalized by state funds and revenues from fees for services, provides loans to eligible private for-profit enterprises.

- JEDA administers a tax-exempt industrial development bond (IDB) program designed to allow small and medium-sized manufacturing and non-profit corporations access to capital markets for financing at rates lower than could be acquired through commercial institutions.

- In order to provide working capital for making loans, CCIC has a revolving line of credit not to exceed $2,000,000 with four South Carolina banks. The corporation can obtain advances and repay them on a revolving basis with interest charged at the prime interest rate. This line of credit also funds an Export Working Capital Guarantee Program that guarantees loans to South Carolina businesses involved in exporting.

In FY 89-90, JEDA began administering the Division of Economic Development's (Governor's office) loan portfolio and is responsible for the accounting and collection of these loans.

In the administration of its various lending programs, JEDA is authorized to set interest rates on bonds without Budget and Control Board approval, renegotiate a loan in default, waive a default, forgive all or part of a loan, bring foreclosure actions, and dispose of collateral. In the event of failure or default relating to JEDA's or CCIC's financial transactions, neither the state nor JEDA has any financial liability above and beyond any commitment or pledge from a specific revenue or source, as stated within the terms of the individual bond issue, loan, or other transaction.

JEDA Administration

On July 1, 1992, JEDA transferred its 22 employees, net assets of $17,884, and furniture and equipment valued at $50,632 to CCIC. JEDA entered into a servicing agreement whereby CCIC would conduct, manage, and operate JEDA's day-to-day business operations. These activities include marketing, underwriting, and credit analysis. To comply with HUD requirements, the executive director and a loan administration officer were subsequently transferred back to JEDA.

Also, in 1992 amendments to JEDA's legislation exempted JEDA and CCIC from most state oversight:

- Employees of JEDA and CCIC are not considered state employees except for participation in the state retirement and health insurance systems.

- JEDA was exempted from the state procurement code (except for minority businesses provisions). Any corporation formed by JEDA is considered to be a public procurement unit, which allows JEDA to contract with such a corporation as if it were another state agency.

- JEDA is exempted from §2-7-65 which requires agencies to file budget requests and program evaluation information.

- Both JEDA and CCIC are exempted from state personnel rules, including those of the Agency Head Salary Commission. Approval from the Joint Legislative Committee on Personnel is no longer required to exceed the number of positions authorized in the general appropriation act.

In his FY 92-93 budget proposal, the Governor recommended that the general fund appropriation for JEDA be phased out within two years, and that JEDA become a self-sufficient enterprise agency. However, in FY 94-95, JEDA received $125,000 in general funds and is budgeted to receive this amount again in FY 95-96. These funds are not appropriated directly to JEDA but instead are appropriated to the State Budget and Control Board's Division of Local Government which then transfers the funds to JEDA. As a result, JEDA appears self-sufficient while continuing to receive state appropriations (see Appendix C).

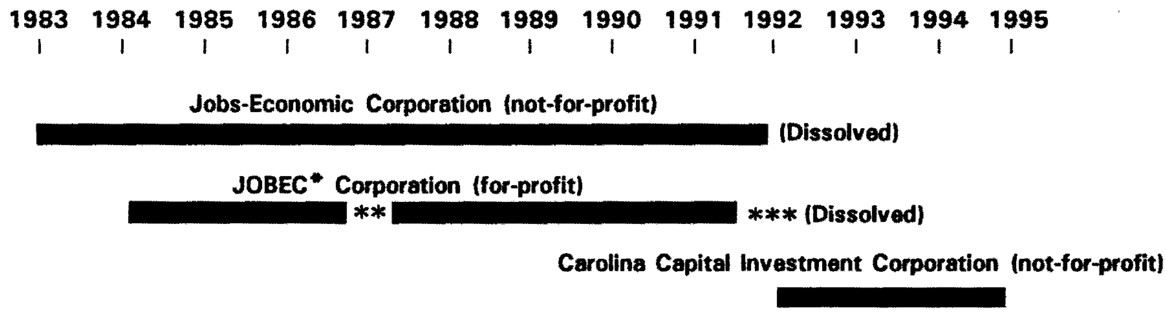
Corporate Affiliates

Under §41-43-240 of the South Carolina Code of Laws, JEDA is authorized to establish for-profit or not-for-profit corporations to carry out the purposes of the Economic Development Fund Act. Terms and conditions of corporate responsibilities are to be defined by JEDA.

JEDA's current corporate affiliate, Carolina Capital Investment Corporation, operates as a not-for-profit corporation with a corresponding purpose to that of the previous corporation. It was created "to act as a development finance institution to promote the growth of productive private investment . . . ." The corporation was created as an eleemosynary entity in order to participate in certain lending programs which were not available to its for-profit predecessor. Corporate assets must be distributed to JEDA or the state in the event of CCIC's dissolution.

Following are two graphs of the corporations as established by JEDA. The first shows corporate affiliates established and the second their capitalization with state funds.

Graph 1.1: Corporate History

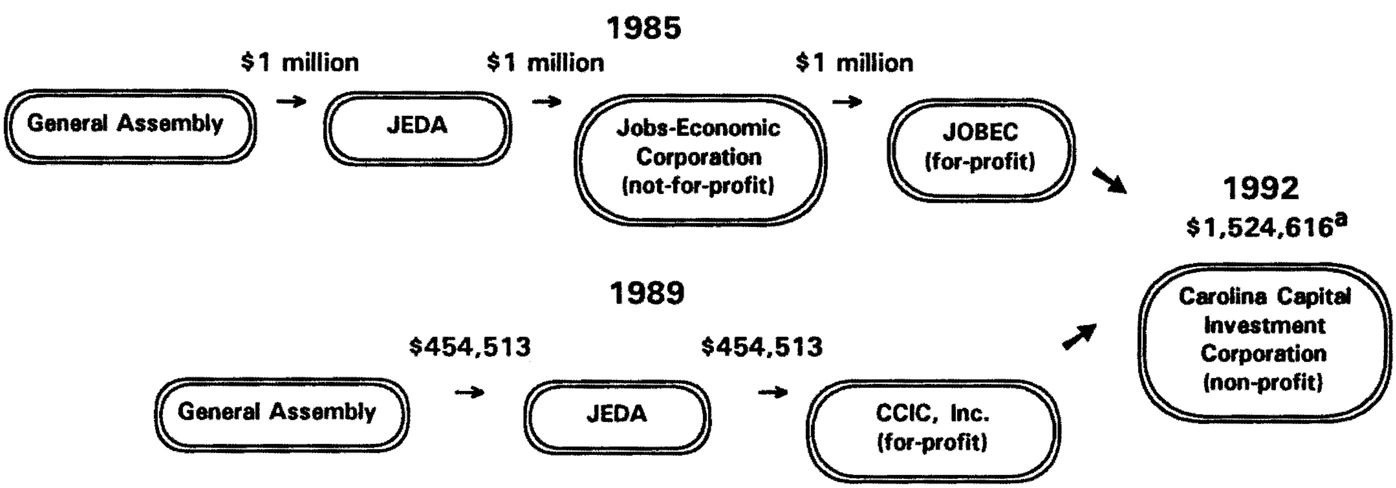


* This for-profit entity was referred to as the "mirror" corporation of JEDA. The term was used to describe the Board of Directors of the corporation which was identical to JEDA's board.

** Changed name to Carolina Capital Investment Corporation (for-profit).

*** Changed name to CCIC, Inc. (for-profit).

Graph 1.2: Capitalization of Corporate Affiliates With State Funds



a According to audited financial statements, June 30, 1994. This includes initial state-funded capitalization as well as retained earnings and net assets transferred by JEDA.

CCIC's Board of Directors consists of seven members. One member is the chairman of JEDA's board who also serves as CCIC's chairman. Two other members are also members of JEDA's board. The remaining four members are appointed by CCIC's board and, according to by-laws, cannot be members of the JEDA board but should be qualified persons with experience in the fields of business, commerce, finance, banks, or economic development.

CCIC Capitalization

According to correspondence received by the LAC from JEDA's chief operating officer (CEO), JOBEC Corporation, JEDA's for-profit corporation, did not issue any capital stock. However, an amendment to the articles of incorporation dated January 26, 1987, indicates that 5,000 shares of stock were outstanding. We have been unable to determine the basis for the mention of outstanding shares in this document. Since the corporate officers signed the amendment showing the issuance of the shares, the attorneys who prepared the document confirmed to the LAC they have no reason to doubt its validity and correctness.

The same act that appropriated the funds to JEDA, amended JEDA's statute to authorize it to make grants to any *not-for-profit* corporation. Had the General Assembly intended to authorize JEDA to make grants to for-profit in addition to not-for-profit corporations, it would have written the law accordingly. JEDA accomplished indirectly (by passing the funds through a non-profit corporation) what it lacked the power to do directly.

In addition, it appears that the action taken to transfer the funds from the non-profit corporation may have violated its Declaration and Petition for Incorporation which states ". . . the Corporation's property shall not be conveyed to any organization created or operated for profit . . . ."

Economic Development Goals

JEDA's principal mandate is to provide economic development financing to small and medium businesses which need capital in order to retain or create jobs. The number of jobs attributed to JEDA's client businesses as a result of loan activity is an important measure of the success of its programs. While some of JEDA's programs have helped businesses expand and create jobs, we found that JEDA overstated the jobs attributed to its loan programs. In violation of its statutes and by-laws, JEDA allows a committee of the board or an employee to approve loans. We also reviewed JEDA's ability to safeguard loan funds from losses. In one case we found CCIC invested in a corporation in exchange for stock which may be prohibited by the South Carolina Constitution. The entire investment was charged off as a loss.

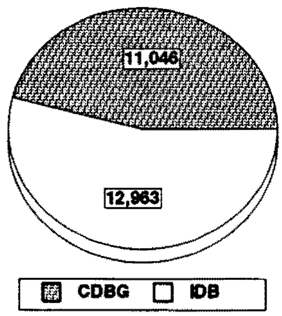
We considered other performance measures as well as strategic planning. We excluded 5 of JEDA's 11 loan programs from review because they either had no activity or had issued few loans. Additionally, we have included a review of three other financing programs that were not efficient or effective in creating jobs, and as currently operated may not be designed to meet key economic development goals.

We also reviewed a sample of loans to evaluate JEDA's administration of its CDBG and CCIC revolving loan funds, including policies and procedures regarding collateralization, eligibility, use of loan proceeds, and conflict of interest. Loan policies and procedures are established in order to control JEDA's exposure to loss, safeguard use of program funds, and ensure that borrowers are eligible to participate in the program. Our findings in this area are based on a sample of loans and suggest some problems.

Job Creation

JEDA has significantly overstated its job creation/retention figures in its annual report to the General Assembly and the Governor. In its FY 93-94 annual report, JEDA stated it had created or retained 24,009 jobs since its inception. We question the accuracy of this number and find it unreliable as a measure of program success. Also, JEDA takes "credit" for retained jobs without first determining that its loans made the critical difference in a borrower's ability to keep these jobs.

Total Jobs Created/Retained Reported by JEDA



Job creation and retention is an important measure of the effectiveness of JEDA's economic development programs. Section 41-43-70 of JEDA's enabling legislation states that one of its goals is to ". . . provide maximum opportunities for creation and retention of jobs . . . ." Section 41-43-260 requires JEDA to report annually ". . . a good faith estimate of the number of jobs retained or created as a result of the authority's assistance." JEDA does monitor businesses that have received assistance to verify employment and compliance with CDBG regulations, but has no written policy on how jobs are to be counted. In order to evaluate the results of these programs, JEDA should report information related to program outcomes fully and accurately. By not accurately counting jobs, JEDA has overstated its effectiveness in the creation and retention of jobs.

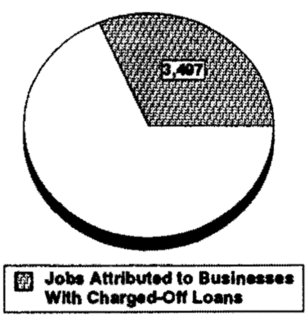
The 24,009 figure is comprised of two major categories, jobs created or retained through the CDBG direct loan program and jobs created or retained through the industrial development revenue bond (IDB) program.

CDBG Program

For the CDBG program, JEDA's FY 93-94 annual report includes 11,046 jobs that have been created or retained since JEDA's inception in 1983. We determined that this number included 3,497 jobs attributed to businesses which had gone into default and/or bankruptcy (charged-off), resulting in the loss of these jobs as well as loan funds. For example, one company for which JEDA claimed 1,883 jobs went out of business approximately six months after JEDA made the loan; as of 1994 this company had one employee.

Jobs Counted as Both Created and Retained

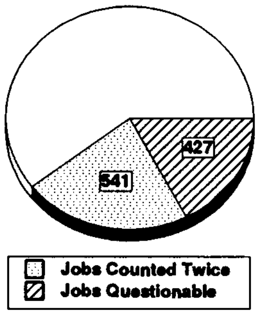
11,046 Jobs Attributed to CDBG Program



We reviewed job monitoring records for a judgmental sample of 24 CDBG loans. For these 24 loans JEDA counted a total of 2,462 jobs. We found, however, that 541 of these jobs had been counted twice, first as created jobs and then as retained jobs. For example, JEDA made a loan to a company to which it attributed the creation of 326 jobs. A year later, the company was experiencing a cash flow crisis and JEDA made a second loan for the purpose of retaining the previously created jobs. JEDA's FY 93-94 annual report attributes the creation/retention of 652 jobs to the two loans made to this company. In a second case, a company received two loans under similar circumstances. The first loan created the jobs and the second loan retained them. JEDA attributed 430 jobs to the two loans made to this company.

The total number of jobs attributed to these companies, therefore, is 1,082. We reviewed the monitoring reports available and found that the total employment for these loans was 347, a difference of 735 from the number of jobs JEDA attributed to these companies.

Sample of 24 CDBG Loans



Retained Jobs

JEDA claims credit for retaining jobs when it is questionable whether the jobs would have been lost without JEDA's assistance. For example, JEDA made a loan to one company for the purpose of retaining 90 jobs and creating 30 additional jobs. However, a monitoring report done by HUD found that the loan had been made without any indication that the company was about to close. Thus, it is questionable whether the 90 retained jobs should have been counted. We found five other loans where JEDA included retained jobs in its jobs figure where we question the inclusion of these jobs. JEDA counted 914 jobs created/retained for these six loans. However, based on our review, only 487 jobs should have been counted, a difference of 427 jobs.

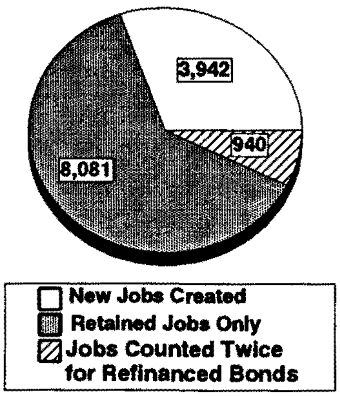
Projects Funded With Other Government Agencies

In our sample, we found two instances where projects were funded by more than one government agency. However, JEDA claimed all of the jobs as resulting from its loans. For example, both JEDA and the Governor's office Division of Economic Development (DED) provided CDBG funds for a company that anticipated creating 281 jobs. In another instance, a company received both CDBG funds from JEDA and federal Economic Development Administration (EDA) funds through a local Council of Government (COG). Both required creation of jobs as part of the requirement for receiving the funds.

IDB Program

For the IDB program, JEDA's FY 93-94 annual report includes 12,963 jobs as being created or retained through the program. This number is overstated by 940 jobs. Our numbers differ from JEDA's because JEDA does not always incorporate its most recent monitoring reports in bond data. Also, JEDA counted the same jobs twice for companies which refinanced an earlier bond with a new bond. In reviewing job statistics, we examined JEDA's bond applications and job monitoring records for the 88 bonds JEDA issued before September 30, 1994.

12,963 Jobs Attributed to IDB Program



Retained Jobs

Of the 12,023 jobs we identified, 8,081 (67%) were jobs that were retained; only 3,942 (33%) actually were created after the companies received bond financing. Since all businesses applying for IDBs must demonstrate financial stability it is questionable whether these jobs would have been lost without JEDA's assistance. For example, JEDA issued a bond in 1990 for the purpose of funding a hospital expansion. At the time the bond was issued, the hospital had 1,083 employees. By 1993, the hospital's total employment had grown to approximately 1,500. This is the job figure included in JEDA's FY 93-94 annual report for this bond. Since the bond was to pay for an expansion, it is questionable whether JEDA's actions resulted in the retention of the 1,083 jobs that existed at the time the bond was issued.

Of the 88 bonds issued, 10 (11%) were issued within the past 18 months; 2 (2%) never actually funded a project; 60 (68%) resulted in new job creation; 16 (18%) did not create new jobs.

No Written Procedure for Counting Jobs

JEDA has no written procedures on how jobs should be counted. We discussed with JEDA officials how they arrived at the 24,009 job figure. Initially, we were informed that the figure was based on actual jobs as shown in the most recent monitoring report, *not* the company's "historical high" employment level. Also, according to JEDA officials, a job should exist at least six months before it is included in JEDA's total jobs figure.

After our inquiry, JEDA revised its method of accounting for jobs. Under the new method, monitoring visits are done and the company's "historical high" employment level *is* used to determine the number of jobs created/retained. A revised Job Creation Report for February 23, 1995, shows a total of 9,154 jobs created or retained by JEDA's CDBG program since its inception. This figure is a reduction of 17% from the 11,046 figure used in the annual report, but continues to include jobs from charged-off loans and jobs which are funded by more than one government agency.

In addition, under this new methodology JEDA is counting jobs at all plant sites even though the CDBG loan was made when the company had only one plant. For example, after receiving a CDBG loan, one company built several plants, including one plant outside the county in which the original CDBG grant was made. JEDA counts the jobs at all the plant sites built after 1986. JEDA counts 897 jobs (10% of its revised total) as being created/retained by this one loan.

One way to better link job creation/retention with JEDA's programs would be a survey of client businesses. This would allow JEDA to determine if the decision to retain employees and/or hire new ones would have been made in the absence of a JEDA loan or bond issue.

Recommendations

1 JEDA should establish written procedures for counting and reporting job figures. These should include:

- What percentage of jobs are created versus retained.
- What percentage of jobs are attributed to loans that have been charged off.
- What other programs are participating in these loans and are counting the same jobs in their reporting.

2 JEDA should only count jobs as created or retained when its activities have a direct effect in creating or retaining the jobs.

3 JEDA should survey client businesses to help determine the impact of its programs on job creation and retention.

Loan Approval Procedures

JEDA is in violation of its statutes and by-laws when approving loans. Under the current system, JEDA has a loan committee made up of selected members of the board. The loan committee receives information from staff and either approves or denies loan applications. According to JEDA officials, board ratification is required only in cases where the loan committee's decision does not follow agency lending policy. In addition, both JEDA's and CCIC's Boards of Directors in 1995 approved a policy which gives loan officers the authority to approve loans up to $50,000 without the approval of the loan committee.

JEDA's statutes and by-laws do not permit a committee of the Board of Directors to officially approve loan applications. Nor do they permit approval to be granted by one employee. Section 41-43-60 of JEDA's statutes and Article 1, Section 4, of the by-laws both require approval of a majority of the board to take action. Therefore, the commitment to lend money can be taken only by a majority vote at a duly convened board meeting.

Recommendation

4 The Board of Directors of JEDA should comply with legal requirements when approving loans.

Defaults and Charge-Offs

We reviewed JEDA's administration of its loan portfolios, particularly its policies and procedures regarding loan payments that are deferred, delinquent, in default or charged off as uncollectible. Delinquent loans are defined as loans where payments are 30 to 59 days past due; defaulted loans are 60 or more days past due.

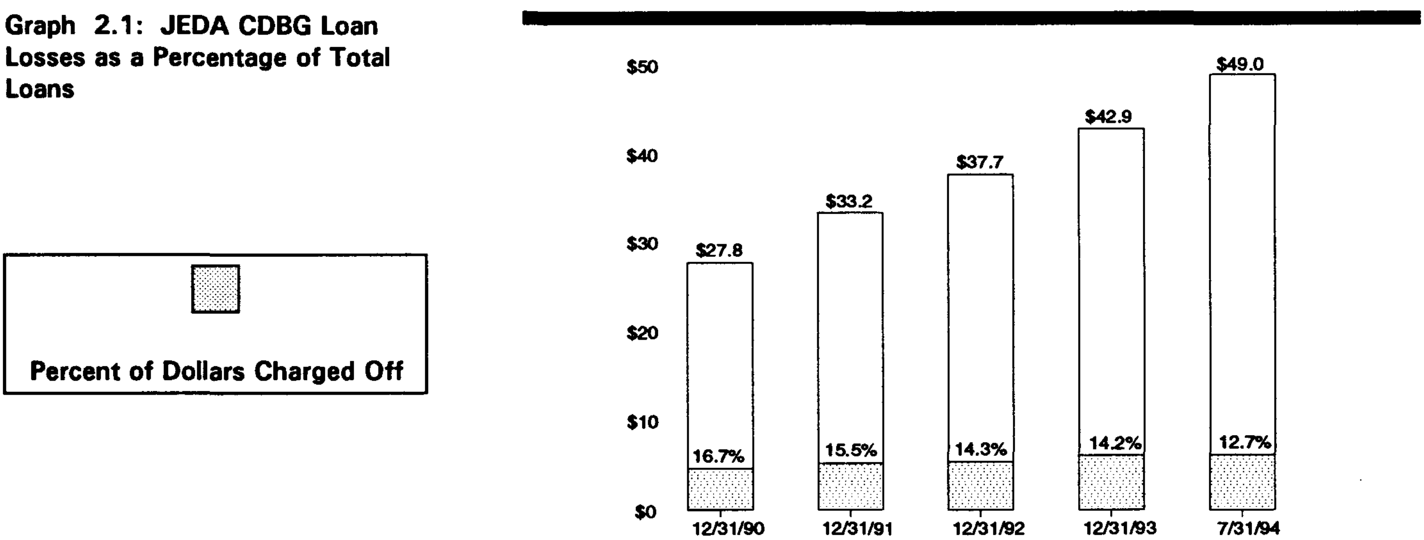
JEDA must safeguard the assets of three revolving loan funds: its main CDBG direct loan program; the CCIC direct loan program; and a second CDBG portfolio that was turned over by the Division of Development (DED) of the Governor's office to JEDA for servicing. The CCIC loan portfolio showed only two charged-off loans. One of these loans was an equity investment and is discussed on page 18. The CDBG and DED loan programs are discussed in the following pages.

Charged-Off CDBG Loans

We reviewed the total amount of outstanding loan balances that proved uncollectible since the inception of JEDA's CDBG direct loan program in 1983. JEDA's legal costs from debt collection and representation in bankruptcy matters amounted to about $25,700 for loans that were charged off from FY 90-91 through FY 92-93. This did not include the additional costs of staff resources and court fees.

By July 31, 1994, out of a total of 168 individual CDBG loans made by JEDA, 24 (14.3%) had been charged-off. This accounted for a total of $6,238,906 in outstanding loans that were not collected (principal and accrued interest only). Of the 24 charged-off loans, 18 charged off 90% or more of the original loan amount. The following graph offers more detail.

Graph 2.1: JEDA CDBG Loan Losses as a Percentage of Total Loans



As Graph 2.1 shows, JEDA's losses as a percent of cumulative loans disbursed have been decreasing. All but two of these bad loans were made prior to FY 88-89; the average time between when the loan closed and when it was charged off was almost four years. Since borrowers with uncollectible loans are usually in bankruptcy and foreclosure proceedings, the process of charging off a loan can be a lengthy one. JEDA usually is behind other lenders, and often has been unable to recover sufficient collateral. Pages

35–39 of this report review specific cases where charged-off loans were inadequately collateralized.

CDBG Loans Deferred, Delinquent, or In Default

We also reviewed the amount of loans outstanding that were in deferred, delinquent or default status. Some of these loans ultimately may be charged off; in other cases the borrower will become financially stronger and resume payments. We based our analysis of default rates on one performed in May 1993 by a consultant which was reviewing JEDA's loan portfolio.

Table 2.1 shows the average deferred, delinquency, and default rates as a percent of loan dollars outstanding (i.e., not the original loan amount but the amount of principal still owed.)

We noted one trend from this information: JEDA increasingly is allowing borrowers to defer loan payments. A deferred loan means the borrower cannot pay in full according to the original note. By allowing deferred payments, JEDA may be avoiding a delinquency or default on these loans. However, this may understate future rates of delinquent and defaulted loans.

Table 2.1: Average Rate of JEDA CDBG Loans Deferred, Delinquent, or In Default

	5/31/88	5/31/89	5/31/90	5/31/91	5/31/92	5/31/93	5/31/94
Average Balance Due	$13,065,724	$15,378,537	$14,383,278	$13,898,492	$15,113,447	$17,233,315	$16,530,189
Deferred	8.04%	6.64%	2.29%	7.37%	11.06%	10.59%	17.75%
Delinquent	6.15%	3.51%	5.28%	2.86%	4.59%	1.84%	2.04%
Default	10.70%	27.54%	15.93%	14.95%	2.88%	5.92%	7.33%
Deferred, Delinquent, Default	24.89%	37.69%	23.50%	25.18%	18.53%	18.35%	27.12%

Source: "State of South Carolina, Jobs/Economic Development Authority Analysis of CDBG Loan Portfolio," performed by Williams, Adley & Co., and Chemical Securities, Inc.; also, monthly Loan Portfolio Analysis from June 1993 through May 1994.

Asset Securitization Transaction

On April 13, 1994, JEDA sold a portion of the cashflow from the repayment of its CDBG loans to a private foundation. Called an "asset securitization transaction," this sale was the first of its kind to use CDBG-funded loans.

Under the terms of the transaction, JEDA transferred 45 selected CDBG loans to a trust. This created a pool of assets which collateralized "securities" in the form of senior and subordinate certificates. An investor then purchased the senior certificates and JEDA received $7,068,105 from the sale. In essence, this enabled JEDA to have $7 million to immediately re-lend rather than wait for the loans to be repaid.

The sale had been encouraged by HUD as a way to infuse new funds into CDBG lending programs. JEDA was able to perform the transaction because of the size of its portfolio, length and accuracy of its payment histories and uniformity of its loan standards. The sale had a temporary effect on the rate of loans outstanding that were deferred, delinquent, or in default; for June and July 1994, the total of these categories averaged 49.38%. This is because any loans with possible problems were not included in the securitization transaction and remained with JEDA. However, as JEDA lends out the proceeds from the sale the rate of delinquent and defaulted loans should fall.

Loan Losses as a Program Indicator

Given the fact that JEDA provides "gap financing," often takes a secondary position behind other lenders, and is supposed to target small and start-up businesses, loan defaults and charge-offs must be interpreted carefully. At the same time, JEDA must properly safeguard CDBG funds from loss. We found that JEDA's losses are higher than other in-state economic development loan programs.

The city of Columbia has a revolving loan fund for economic development which consists of mostly Economic Development Administration (EDA) funds and some CDBG funds. A city official reported a loss rate of 3% as of January 1995.

The Business Development Corporation of South Carolina (BDCSC) is a private, non-profit lender, and its loans are backed by Small Business Administration (SBA) guarantees. BDCSC loans to businesses that have been turned down by commercial banks; their charge-off rate is less than 2%.

The SBA's charge-off rate for its General Business Program, which consists largely of loan guarantees, was 7.26% in South Carolina for 1993.

Each of the ten regional Councils of Government (COGs) operates a revolving loan fund in order to provide gap financing to businesses which cannot obtain 100% financing from commercial banks. We surveyed the ten COGS by telephone: as of January 1995, seven of the COGS have experienced charge-off rates of 0% to 3%; two had charge-offs of 10%; one had a 26% charge-off.

It is difficult to determine what an acceptable rate of uncollectible loans should be for a program like JEDA's. A report on the CDBG program released by the General Accounting Office in February 1994 noted that:

> . . . there is no established acceptable default rate for CDBG economic assistance loans. However, given that such loans are usually made to businesses that cannot obtain sufficient private financing, a higher than normal default rate might be expected . . . . A zero default rate may indicate that local grantees are too conservative in the loans they make. In contrast, a default rate that is too high may indicate imprudence.

DED Loans

JEDA also administers another CDBG loan portfolio. From 1983 to 1993, the Division of Economic Development in the Governor's office also made economic development loans. JEDA assumed responsibility for these loans in 1989. In all but two or three cases, JEDA had not participated in decisions to award the DED loans; credit analysis and lending decisions had been performed by DED staff. JEDA now collects the payments and, for most of the loans, returns them to JEDA's own revolving loan fund.

The DED CDBG loan portfolio turned over to JEDA consisted of 48 loans as of September 1994, eight of which have been paid off. Twelve have been charged off, resulting in a loss of $1,980,617, or 12.36% of original loan amounts. In nine of the charged-off loans, borrowers failed to make any payments.

The following table shows the DED loan portfolio for the past three fiscal years. We found that the percentage of DED loans in deferred, delinquent or default status was higher than the JEDA loans. According to DED officials, DED loans have more problems because DED's lending policy was less strict and less specific than JEDA's.

Table 2.2: DED Loan Portfolio: Average Rate of Loans Deferred, Delinquent, and In Default

	FY 91-92	FY 92-93	FY 93-94
Average Balance Due	$6,618,818	$7,486,505	$8,852,983
Deferred	29.78%	39.55%	47.60%
Delinquent	20.29%	2.65%	0.81%
Defaulted	8.78%	24.07%	12.79%
Deferred, Delinquent, Defaulted	58.84%	66.26%	61.20%

Sources: DED Loan Portfolio Analysis, JEDA.

Monitoring Faulty Loans

The sometimes substantial numbers of delinquent and defaulted loans indicate that these borrowers are having financial problems. JEDA tracks problem loans through a weekly "delinquency" report that flags loans with late payments and shows what actions staff have taken. However, we identified other steps JEDA could take in responding to default situations.

- According to economic development experts, small and new businesses need technical assistance at least as much as they need low-interest loans to survive. Many businesses fail because of management problems rather than from a lack of capital. Also, §41-43-90 gives JEDA express authority to provide management counseling and technical advice. However, JEDA's and CCIC's procedures do not incorporate this as a part of monitoring businesses with problem loans. If JEDA or CCIC cannot directly advise businesses with financial problems, it could refer businesses to other sources of technical assistance such as Small Business Development Centers.

- JEDA's lending policies do not spell out what steps loan administration can or should take in responding to problem loans. JEDA can help a company restructure its loan payments, for example, but officials have stated they cannot go beyond this. A written policy clearly stating when and under what circumstances JEDA should intervene, what actions it should take and what legal authority it has in these situations, would help JEDA become more proactive in responding to problem loans.

- We found that for at least 7 (29%) of the 24 charged-off loans, principal payments were deferred from the beginning of the payment history. This could have been an indication that these would be high-risk loans. While JEDA monitors all loans, it does not have a system to classify high-risk loans. Loans classified as high-risk could then be scheduled for more frequent monitoring visits and financial review. (After JEDA reviewed our draft report, they indicated that a loan rating system would be developed and presented to the board.)

Recommendation

5 JEDA should consider the following actions to help businesses with loan payment problems.

- Develop a system to refer businesses to sources of technical assistance.
- Develop a system to classify loans based on level of risk, and establish more detailed procedures on responding to problem loans.

Equity Investment by CCIC

We found that CCIC invested $100,000 in a corporation in exchange for common stock. It appears that this type of transaction would be prohibited by Article X, §11 of the South Carolina Constitution, which states, "Neither the State nor any of its political subdivisions shall become a joint owner of or stockholder in any company, association, or corporation . . . . "

It appears that this type of transaction would be prohibited by Article X, §11 of the South Carolina Constitution.

In July 1988, CCIC signed an investment agreement in which CCIC received 2,915 shares of common stock in exchange for a $100,000 investment in the corporation. CCIC's investment represented a 22.5% interest in the company.

By June 1989, less than one year after CCIC's investment, the corporation filed for bankruptcy protection. CCIC did not receive an unqualified opinion on its financial statements for the period ending June 30, 1989, due to the CPA's inability to satisfactorily determine the value of CCIC's investment. Since the transaction was structured as an investment, CCIC had not required collateral or a personal guarantee from the principal.

In March 1990, CCIC's Board of Directors voted to charge off the entire amount of $100,000 after legal counsel reviewed documents filed with the Bankruptcy Court and concluded that the investment was worthless.

Since CCIC is limited to functioning, in effect, in lieu of JEDA, it is questionable whether CCIC could lawfully own stock in a private company when JEDA as a state agency is prohibited from doing so.

Recommendation

6 In the event JEDA or an affiliated corporation considers becoming a joint owner or stockholder of a company in the future, JEDA should first seek an attorney general's opinion to clarify whether such a transaction would be prohibited by Article X, §11 of the State Constitution.

Strategic Plan

JEDA has no strategic plan of its own which would help it meet legislative and program mandates, assess client needs, develop new programs, and fit in with statewide economic development policy. In FY 88-89, JEDA, as a member of the South Carolina Coordinating Council for Economic Development (CCED), participated in a statewide strategic plan which resulted in several broad economic development initiatives. According to the director for the coordinating council, the objectives of the plan have been accomplished where possible. There is currently no new statewide economic development plan.

JEDA needs a strategic plan with specific goals and benchmarks. Otherwise, JEDA cannot say . . . that its programs have been effective.

JEDA's legislation directs it toward several global objectives, including:

> . . . to provide maximum opportunities for creation and retention of jobs and improvement of the standard of living of the citizens of the State, and . . . in the promotion and advancement of industrial, commercial, agricultural, and recreational development in this State.

Furthermore, JEDA's statutes [41-43-70] direct it to ". . . encourage and assist through loans, investments, research, technical and managerial advice, studies, data compilation and dissemination and similar means in the location of new business enterprises in this State and in the rehabilitation and assistance of existing business . . . ."

However, we found that:

- JEDA has not defined its role in statewide economic development efforts.
- JEDA has not developed goals and measures which would show the impact of JEDA's programs.
- JEDA has not performed studies, research or data compilation that would assist businesses needing economic development information.

For example, the South Carolina secretary of state's office in 1993 produced a handbook on economic development incentives in South Carolina. This 300-page handbook lists multiple tax, financial, technical and other incentives available for business development. JEDA needs a strategic plan to describe how its programs coordinate with other economic development incentives offered by federal, state, and local governments and non-profit organizations.

In some areas, such as issuing tax-exempt industrial development bonds, JEDA duplicates other government agencies (see p. 26). JEDA's export guarantee program is eclipsed by similar programs which offer more extensive services (see p. 29). There is little identifiable need for yet another JEDA loan program, the Palmetto Building Fund (see p. 30). In fact, there are five other lending programs we did not review in-depth because either they had no activity or had issued few loans. A strategic plan would help JEDA direct its resources to where they are truly needed instead of into programs for which there may be little market demand. JEDA could use CCIC's capability to develop a strategic plan.

Possible performance measures are discussed below and are not necessarily all-inclusive. Given its broad mandate and its limited resources, JEDA needs a strategic plan with specific goals and benchmarks. Otherwise, JEDA cannot say with any authority that its programs have been effective in creating jobs and promoting economic development in this state.

Goals and Performance Measures Needed

JEDA has not established specific goals that deal with the effectiveness and quality of its programs. Furthermore, JEDA has not always collected the data which would enable it to evaluate its programs, even though most of these data are available.

JEDA from FY 90-91 through FY 92-93 set program goals that dealt with "outputs"; these consisted only of setting targets for number of loans, dollar volume of loans, and number of jobs created/retained. JEDA should go beyond merely counting the number of loans made or jobs created in determining the effect of its programs on client businesses and the economic welfare of South Carolina citizens. In addition, loan growth can be a perverse incentive, encouraging loans even when it would be better not to make the loan. This is especially true since CCIC's income depends on loan volume.

We reviewed economic development studies prepared by the Urban Institute, federal CDBG program criteria, the statewide economic development plan of 1988, and the original legislative findings contained in Act 145 that established JEDA in 1983. From these sources we developed a list of possible economic development goals and performance indicators. Two important measures of performance are discussed elsewhere—jobs created and retained on page 7 and the amount of private investment leveraged on page 40.

Indicators of Job Quality

Indicators of job quality include above-average wage rates, job duration (all year versus seasonal), potential for advancement, and potential for worker training. Targeting job quality as a goal would address the legislative findings of Act 145 of 1983 that, "Low wage rates and high levels of unemployment have contributed to the continuation of poverty and its attendant ills . . . ."

JEDA requires borrowers to provide information on wages and job descriptions for projected jobs. However, we found no evidence that JEDA collects and analyzes these data to determine the quality of jobs JEDA loans are helping to create.

JEDA states . . . that it targets "projects which offer the most economic growth and diversity to the state. . ."; however, we found no evidence that such "targeting" does occur.

Targeting Specific Firms

The CCED statewide strategic plan called for increasing employment in high growth, high value-added service industries, and for diversifying the state's industrial base away from reliance on textile manufacturing. We reviewed the Standard Industrial Classification (SIC) codes of firms receiving JEDA loans to see if these kinds of businesses were targeted by JEDA. SIC codes identify firms by type (manufacturing, service, retail, etc.) and product line (paper, food, textiles, etc.). We determined that since 1983, JEDA had made

40 CDBG loans for a total of $13,319,958 (25% of its portfolio) to textile and apparel manufacturing firms. Since the early 1980s, this segment of the state's economy has lost employment.

JEDA states in its annual report that it targets "projects which offer the most economic growth and diversity to the state . . ."; however, we found no evidence that such "targeting" does occur. Also, while JEDA has SIC codes for the businesses which receive CDBG loans, it does not analyze this data to determine what kinds of businesses receive assistance.

Targeting Historically Economically Distressed Counties

The statewide economic development plan also addressed the need to bring economic development to the rural and poor areas of South Carolina. JEDA's legislation directs it to develop a definition of historically distressed counties; JEDA is allowed to make working capital loans in such areas. JEDA also states in its annual reports that its programs are ". . . targeted to areas of the state that have the greatest need for public and private investment . . . ."

As of September/October 1994, we found that only 43% of CDBG loan funds and 7% of bond financing has actually gone to businesses locating in historically distressed counties. JEDA has the necessary data to analyze the geographic distribution of its lending activity, but has not done so.

Targeting Small and Medium Businesses

JEDA's legislative mandate (§41-43-70) directs JEDA's programs to ". . . give consideration to the development of and assistance to small businesses in this State as may be defined by regulation of the authority." In addition, JEDA is to report on the size of businesses receiving assistance (§ 41-43-260). And according to economic development literature, many new jobs in the U.S. are created by small and start-up firms.

However, as discussed on page 25, JEDA no longer focuses on small businesses through its composite bond program. Also JEDA has not collected data to show that it is in fact helping small businesses obtain capital and expand; it has not formally defined "small business," but rather uses a rule-of-thumb definition of "under $1 million net worth."

This definition is inadequate; for instance, it does not account for the wealth of parent corporations. In our sample of CDBG loan files, one new company receiving two CDBG loans was actually a wholly-owned subsidiary of a larger corporation with a net worth of more than $10 million.

The Small Business Administration (SBA) defines a small business as one which is independently-owned and is not dominant in its field. Businesses must also meet a size standard based on the total number of employees per firm and which varies by type of industry. This better targets businesses that really need government loans.

After JEDA's staff reviewed our draft report, they developed a definition of "small business." We have not evaluated the adequacy of this definition (see Appendix D).

Quality of Service

Periodic surveys of businesses and local economic development officials could measure the performance of JEDA and CCIC staff in processing loan applications and in responding to clients' concerns and questions. These client surveys could also assess businesses' need for technical and managerial advice.

Recommendations

7 JEDA should develop a strategic plan with specific goals and performance measures. In doing so, it should ensure it coordinates with statewide economic development efforts and programs. JEDA should, to the extent possible, use CCIC staff to develop the plan and compile data for performance indicators.

8 JEDA should collect and analyze data, such as wage levels and job descriptions, that reflect the quality of jobs created.

9 JEDA should use its SIC codes to determine what types of businesses are obtaining JEDA loans and if this reflects statewide economic development priorities.

10 JEDA should analyze data on the geographical distribution of loans and determine if this reflects statewide economic development priorities.

11 JEDA should survey client businesses to not only assess the impact of its loan programs on job creation, but also to assess quality of service and to determine if clients have unmet needs.

Industrial Development Bonds

The industrial development bond program (IDB) is another major JEDA program. Our review found that IDBs allow businesses to obtain capital at below market rates when needed for a business expansion or to move into South Carolina. Since both the state and the federal government forgo revenue because of the tax-exempt status of these bonds, they are also expected to generate public benefits. We found that JEDA's IDB program is not designed to meet key economic development goals.

Background

Section 41-43-100 of the South Carolina Code of Laws authorizes JEDA to fund loans to businesses and non-profit corporations from the proceeds of tax-exempt revenue bonds. Tax-exempt bonds carry a lower interest rate and are more affordable than conventional loans. This program allows borrowers with capital needs of under $10 million to tap into the municipal bond market. In addition to manufacturing and industrial businesses, JEDA can issue its bonds for non-profit corporations to include hospitals, nursing homes, and other organizations with recognized tax-exempt status under the federal tax code. Federal tax laws do not limit the amount of tax-exempt bond financing that can be issued for non-profit hospitals; other non-profit corporations are limited to $150,000,000 in tax-exempt bonds.

Most of the jobs claimed by JEDA for this program are in fact retained jobs.

JEDA reviews and approves projects as eligible for bond financing. The bond also must be approved by the State Budget and Control Board. JEDA then issues its bonds to be purchased by an investment firm or commercial bank, and loans the proceeds of its bond sale to businesses for the acquisition, construction and/or expansion of proposed facilities. From December 1985 through September 1994, JEDA has issued 88 bonds for a total of $477,141,000.

By state law, neither the full faith and credit nor the taxing power of the state or the issuer are pledged to secure the payment of the principal and interest due. The bonds are payable only from the revenues generated by the project. JEDA acts primarily as a "conduit" and is not involved in repayments of the bond debt to the trustee bank.

Most bonds are secured by a letter of credit (LOC) from a bank. If a bond defaults, the trustee bank deals with the borrower, the bondholders and the LOC bank to enforce the loan agreement. JEDA as issuer is involved only peripherally in a default. Of the 88 bonds issued, we found only three businesses had defaulted on their bonds. Three other manufacturers also had closed but were able to provide for bond payments.

According to information provided by JEDA, all but five of its bonds were secured by a letter of credit or other type of credit enhancement from a bank. We reviewed the five bonds which were not secured by an LOC. Two bonds were backed by unconditional guarantees from parent corporations and carried a high rating; the other three bonds were for nursing homes and retirement centers and were secured by first liens on real estate, property and equipment. These three bonds were not rated. Disclaimers in the official documents disclose the risk factors associated with these bonds to potential bondholders.

Need for Composite Bonds

In the early 1980s, there was concern that small companies did not have access to capital markets to finance business expansions. Act 145 that created JEDA states, "Pooling of capital demands of businesses requires the creation of a statewide authority in order to aggregate the necessary volume of capital demand to access the large financial markets and reduce the cost to each participating business."

Most borrowers in JEDA's bond program would have been eligible for a conventional bank loan, since bonds are usually secured by a letter of credit (LOC) from a bank.

If a small company needed capital financing of $1 million or less, this amount might be too small to access the bond market on its own. At the same time, interest rates on a conventional bank loan would be too high. JEDA was able to issue "pooled" or composite bonds which pooled the financing for several small companies at one time into one large bond, and spread the up-front costs among the several borrowers. JEDA is the only South Carolina economic development agency with the authority to issue composite IDBs.

However, JEDA has issued only stand-alone bonds since 1990, and most of these have been for multi-million dollar projects. According to JEDA officials, they no longer issue composite bonds for several reasons, including the complexity of arranging the composites and changes in the market which made conventional financing more attractive to small businesses.

If the conditions which necessitated the creation of JEDA's bond program have changed, then the need for JEDA to continue issuing bonds should be re-evaluated. In addition, under federal tax laws states have a "state ceiling" limiting the amount of private activity, tax-exempt bonds they can issue. JEDA competes with several other entities for allotments under the state ceiling, which was $178,000,000 in FY 92-93.

Counties have had the authority to issue industrial development revenue bonds for at least 20 years before this authority was given to JEDA also. The State Housing Finance and Development Authority and the State Education Assistance Authority also issue tax-exempt bonds which are allotted under the state ceiling. The State Budget and Control Board determines which bonds are approved, usually on a first-come, first-served basis. From FY 85-86 through FY 92-93, JEDA's share of private activity, tax-exempt bonds ranged from 2% to 23% of the state ceiling.

Also, most borrowers in JEDA's bond program would have been eligible for a conventional bank loan, since bonds are usually secured by a LOC from a bank. A letter of credit provides security for the investors and also lowers the interest rate to the borrower. Businesses have to be financially sound in order to obtain a LOC. This raises the question of whether the state should be forgoing tax revenues, and using limited tax-exempt revenue bonds, for businesses which might be able to obtain financing from private institutions. All tax-exempt state and local bonds (not just JEDA's) issued from FY 92-93 through FY 94-95 comprised approximately $104,821,000 in lost state revenues. The state's economic development needs may be better served by prioritizing uses for tax-exempt financing (see p. 62).

Health Care Facility Bonds

In 1990 and 1991 the fate of the tax-exempt industrial development bond program was uncertain because of the U.S. Congress's failure to permanently authorize it. During this time JEDA began to issue more hospital bonds, which have permanent legislation and are not included under the state's ceiling.

Also, as South Carolina's elderly population continues to grow, JEDA has been called upon to issue more retirement center bonds. The number of state residents over age 65 is projected to increase 25% by the year 2000, according to 1990 census data.

However, it is questionable whether issuing bonds for health care facilities such as hospitals, nursing homes and retirement centers supports JEDA's mission to create jobs. These bonds usually result in little job creation compared to the size of the issue. For example, nine health care and retirement facility bonds have been issued by JEDA since 1990, accounting for 38% of the dollar volume for all JEDA bonds. The amount of financing for each new job created by these facilities averaged $176,512.

Meeting Economic Development Goals

Tax-exempt bonds are expected to generate public benefits in return for the reduction in state and federal revenues. As discussed on page 10, 18% of businesses with bond financing failed to create new jobs, and most of the jobs claimed by JEDA for this program are in fact retained jobs. Bonds are an expensive way to create new jobs compared to other JEDA programs. For example, JEDA has followed a benchmark of $10,000 per job for its CDBG direct loan program. Recently this was changed to $25,000 per job. For bond financing, the average cost per new job was $102,425; for both retained and new jobs it was $38,083. JEDA's bond program is the least efficient way to expand employment opportunities.

Other economic development goals, such as targeting small companies or encouraging investment in economically distressed counties, are not achieved by the bond program. Only 7% of JEDA's bond financing has been for businesses locating in historically distressed counties. The impact of industrial development bonds on economic development goals is also discussed on page 22.

Recommendations

12 JEDA should reevaluate the need for its composite bond program.

13 JEDA should review its need to issue health care facility bonds in view of the low job creation associated with such bonds.

Export Program

Export development programs are viewed as providing considerable economic advantage. In addition to new jobs and increases in tax revenues created by growth in exports, the diversified nature of the world economy makes export trade a valuable hedge against domestic economic downturns. Exports bring in new dollars, rather than shifting dollars within jurisdictions. However, while promoting the export of South Carolina products remains a desirable economic development goal, we found that JEDA's programs may not be effective in this area.

The most jobs that could be attributed to the EWCG is 17.

JEDA's export program was created to promote the export of South Carolina products. Section 41-43-70 of the South Carolina Code of Laws directs JEDA to:

> . . . encourage and assist through loans, investments, research, technical and managerial advice, studies, data compilation and dissemination . . . the promotion of the export of goods, services, commodities, and capital equipment produced within the state, so as to provide maximum opportunities for creation and retention of jobs . . . .

This is the only program operated by JEDA that is specifically mandated by statute.

The program is composed of: Consulting Services; Export Marketing Facilitation Services, i.e. helping exporters to access credit reporting services; Foreign Credit Insurance Association (FICA) umbrella insurance; Eximbank programs; and Export Working Capital Guarantee (EWCG), that provide pre-export working capital loan guarantees. Under the EWCG eligible businesses obtain working capital to be used in filling an export order. CCIC provides a guarantee for up to 85% of the loan amount, not to exceed $170,000, using a line of credit established with four banks.

Obstacles to Program Effectiveness

Since the export financing initiative was established in 1989, only five guarantees have been made; two went to the same company.

The maximum limit of $170,000 may not be sufficient capital to attract business interest. According to the United States Department of Commerce (DOC), South Carolina's top export products for 1994 were equipment, machinery and chemicals, industries dominated by large businesses whose needs may therefore exceed JEDA's EWCG program's financing abilities. JEDA has the authority to use program funds for this program but cannot use state general fund appropriations.

Also, the authority has devoted few resources to export promotion. Based on cost recovery computations from CCIC, the export program is less than 2.03% of CCIC's total cost. The one staff person assigned to this program is the executive vice-president and chief operating officer of CCIC. He is also responsible for the day-to-day operations of CCIC.

Program Activity

Using the United States Department of Commerce (DOC) multiplier formula, the most jobs that could be attributed to the EWCG initiative is 17. JEDA does not know if jobs resulted from other initiatives. This is a very small portion of the overall export jobs created in South Carolina. According to 1993 statistics from the DOC, South Carolina exports increased by $2.5 billion (147%) from 1987 to 1992, which equals the creation of 50,000 manufacturing jobs.

JEDA identifies the Consulting Service as the most active part of the program, resulting in approximately 48 business meetings and approximately 28 foreign business prospects each year. Activities under Export Marketing Facilitation were limited to assisting five businesses in obtaining credit reports and approximately six businesses in obtaining insurance. The official responsible for the program stated that the best use of his time is in getting exposure to large audiences.

Other Programs Available

The need for JEDA's program is questionable because two federal programs, with local offices and accessibility to exporters, offer more extensive services. The Small Business Administration (SBA), provides export financing in the amounts of $750,000 or less, and the federal Eximbank's program serves companies with needs in excess of $750,000. The Eximbank's goal is, in part, to facilitate export financing of U.S. goods and services by absorbing reasonable credit risks that are beyond the current reach of the private sector. The Eximbank financed over $15 billion in export assistance to U.S. exporters in 1994.

SBA uses loans to finance export marketing advice, legal consultations, foreign business travel and participation in foreign trade shows. Guaranty programs and a revolving line of credit are also available as well as development assistance including training, counseling, referrals to exporting service providers and reference materials.

Recommendations

14 JEDA should carry out its statutory responsibility in the export program to provide research, technical and managerial advice, studies, data compilation and dissemination.

15 JEDA should evaluate the implementation of its export program and determine whether current initiatives should be continued as presently structured. Performance goals should be established to include:

- The dollar value of actual increased export sales from client firms.
- The number of actual jobs created from exports.
- The number and percentage of firms that began or increased export trade sales and production as a result of assistance.

Palmetto Basic Building Fund

The Palmetto Basic Building Fund (PBBF) was created to provide loans to local, non-profit economic development corporations (LDCs) for the purpose of constructing speculative industrial buildings. A speculative (spec) industrial building is constructed without a specific tenant in mind but with the expectation that it will be purchased in the future.

A major goal of the PBBF program was to create jobs for workers displaced as a result of Hurricane Hugo (September 1989). This justification is questionable. According to a report prepared by the State Budget and Control Board's Division of Research and Statistics, while there was job loss associated with Hurricane Hugo, "[m]ost of the negative impact on employment directly attributable to Hugo was short-lived." The first PBBF building was not sold until 1993, approximately four years after Hurricane Hugo struck the state.

As of May 1994, JEDA had made five loans totalling approximately $1.8 million. However, only two of the five buildings constructed under the program have been sold, and as of February 1995, only 15 jobs created.

A 1991 article in the Economic Development Review states that, before beginning a spec building program, ". . . it is important to measure both the market demand and supply for additional industrial buildings." Only if the existing inventory of buildings is found to be inconsistent with the requirements of the marketplace should development of a spec building program begin. According to officials involved in the creation of the program, no study or analysis was done to determine the need for additional spec buildings in the state.

Prior to Hugo, South Carolina had 257 industrial buildings which were available for occupancy. As of July 1994, the state had 291 available buildings including 22 spec buildings. JEDA's program is not the only source of spec buildings in the state. According to Department of Commerce figures from September 1994, 19 of the 26 available spec buildings in the state were constructed by private sector companies.

JEDA's policy on collateral for the buildings is to allow principal and interest payments to be deferred for at least two years and up to five years. However, the accrued interest cannot exceed the value of the land upon which the building is constructed. Once the accrued interest does exceed the value of the land, the LDC is required to start making interest payments. However, if the properties are not sold within the five years, it is unlikely that the LDCs will have any means of repaying the loans.

JEDA has already foreclosed on one loan incurring approximately $4,600 in expenses associated with the foreclosure on the building and future costs such as taxes and insurance. JEDA may not be able to collect 100% of the principal and interest due on the building when it is sold. During the course of our review, JEDA officials stated they intend to discontinue the PBBF program.

Recommendations

16 JEDA should discontinue making new loans in the PBBF program.

17 JEDA should review its collateral policy on loans to LDCs for industrial buildings to ensure that LDCs have the assets to make payments once the interest charges exceed the value of land used as collateral.

Borrowers' Eligibility

We reviewed both CDBG and CCIC loan files to assess effectiveness of lending policies in limiting JEDA's exposure and ensuring borrowers' eligibility. Within our sample of 16 CDBG loans and 12 CCIC loans, we found loans made to borrowers with substantial personal net worth (see Table 2.3). This is allowable under the present policy.

The lending policies for both the CDBG and CCIC loan programs state that eligibility under these programs ". . . is limited to private, 'for profit' enterprises with a net worth of less than $1 million and/or a net profit after taxes averaging less than 20% of net worth for the previous three years."

JEDA officials stated that the "principal criteria for credit evaluation is the networth (sic) of the business and not the principals."

We noted that in some instances these borrowers had created a new corporation or partnership whose net worth would qualify under the $1 million net worth limitation, as seen on the table below. While we understand that the businesses rather than the principals are receiving the loans, we cannot agree that providing low-cost capital to subsidize wealthy business owners is an appropriate use of public resources.

Table 2.3: Net Worth of Borrowers

Loan	Type of Loan	Year Loan Was Made	Personal Net Worth of Borrower(s) Per JEDA's Records	Amount Borrowed From JEDA or CCIC	Did Borrower Set Up a New Business for this Project?
A	CCIC	1992	$33,736,718	$287,762*	Yes
B	CDBG	1992	$3,619,761	$500,000*	Yes
C	CCIC	1992	$2,448,000	$200,000*	Yes
D	CDBG	1990	$3,063,000	$175,000*	No
E#	CDBG	1987	$7,200,000	$1,948,936*	No
F	CDBG	1987	$1,820,878	$250,000*	No
G	CDBG	1987	$1,568,000	$250,000*	No
H	CDBG	1983	$4,119,500	$200,000	Yes

* Private funds were used in addition to these funds to provide for total project costs.
\# This company received three CDBG loans from JEDA.

Source: JEDA/CCIC loan files.

HUD recently published new regulations (24 C.F.R. Part 570) for its CDBG program effective February 1995, including "Guidelines and Objectives for Evaluating Project Costs and Financial Requirements." One guideline (Appendix A, paragraph IV,3) states that the proposed projects should be reviewed to ". . . ensure that, to the extent practicable, CDBG funds will not be used to substantially reduce the amount of non-Federal financial support for the activity."

Borrowers who have the resources to either obtain private financing or provide funds of their own should not be allowed to substitute public funds in place of those funds.

While these guidelines were only recently formalized, the underlying premise of these types of loan programs has been that scarce public resources must leverage private funds in order for the programs to be successful. Therefore, borrowers who have the resources to either obtain private financing or provide funds of their own should not be allowed to substitute public funds in place of those funds.

The following examples provide details of loans to borrowers with substantial personal net worth.

Loan A

This loan represents a CCIC loan made to four partners with a combined personal net worth totaling $33.8 million. The partnership was formed in order to own and operate a shopping center. A memo written by the loan officer to the loan committee stated that the "strength of the credit" precluded the use of CDBG funds. The memo appeared to indicate that approval of the loan would benefit CCIC's loan program which had experienced a low volume of activity during the year. In addition, the loan was $87,762 over CCIC's loan limit of $200,000.

In addition, minutes of a loan committee meeting held in October 1992 show that this same partnership applied to CCIC some five months later for an additional loan in order to construct a drug store. CCIC's loan committee unanimously declined this request. The minutes state that "there were lengthy discussions regarding the principals' sizable net worth . . . and the amount of the loan request as compared to the principals' net worth."

Loan B

This loan was a CDBG loan which involved protests from the local community regarding a loan being made to a textile manufacturing plant. When the public meeting was held to receive comments and questions about the loan, several owners of existing textile plants voiced concern over the additional competition for trained workers.

Loan E

This company received three CDBG loans from JEDA. The third loan, made in 1987, refinanced the first two loans and provided an additional $1 million to the company. At the time this third loan was made, a compiled (unaudited) personal financial statement was provided to JEDA by the business' owner. According to this statement, the owner had a net worth of $7.2 million, including three residences totaling over $1.3 million.

Recommendation

18 JEDA should develop appropriate policies to ensure that loans are not made to borrowers with substantial resources, where public funds may substitute for available private funds.

Collateralization of Loans

We found four cases where adequate collateral and/or personal guarantees were not obtained. The resulting loss to JEDA's loan fund was $1,357,893, representing 22% of the total amount charged off.

We found that JEDA and CCIC did not require adequate collateral or personal guarantees for several loans we reviewed. Current lending policies addressing these issues are vague and inconsistently applied, allowing for a variety of loan terms to be made depending on each individual project.

We found evidence of what, in our opinion, constituted a distinct deficiency of collateral or other security. Our sample of 16 CDBG loans included 12 (50%) of JEDA's 24 charged-off loans as of June 30, 1994; we found four cases where adequate collateral and/or personal guarantees were not obtained. The resulting loss to JEDA's loan fund was $1,357,893, representing 22% of the total amount charged off. In addition, we reviewed a judgmental sample of 12 (41%) of the 29 loans made by CCIC as of June 30, 1994. This review included all categories of loans and revealed several concerns regarding insufficient collateralization of loans, as well as a personal guaranty provided by an inappropriate individual (see pp. 39, 42).

Section 41-43-150(C)(6) of the South Carolina Code of Laws states that JEDA may authorize loans to eligible recipients only after it has determined that ". . . the public interest is adequately protected by the terms of the agreements to be entered into in connection with the transaction."

Current lending policies for JEDA's CDBG loan program state that "all direct loans or guarantees should be collateralized" and "personal guarantees from principals may be required." Current CDBG loan policies also require life insurance coverage on the company principals with assignment to JEDA. CCIC's current lending policies state that "all CCIC loans must be secured by collateral." Regarding personal guarantees, CCIC's policies state that they ". . . could be required."

These policies do not define specific terms for collateral or personal guarantees. JEDA provides "gap financing," and in many cases, must accept a second (or lower) position on the collateral provided, such as a second or third mortgage on land and buildings. However, if collateral is inadequate, the amount charged off for defaulted loans increases. Even though lending involves subjective decision making, the terms involving collateral and personal guarantees should be defined as specifically as possible.

The following examples provide details of loans where, in our opinion, JEDA or CCIC should have taken a more conservative approach in adequately protecting loan funds.

Loan 1

In 1987, a company received from JEDA a third CDBG loan which refinanced two existing CDBG loans and provided an additional $1,000,000. The terms of this loan required the principal to provide a personal guarantee ". . . in an amount equal to fifty percent (50%) of the total indebtedness of the Business (sic) to JEDA." The terms did not require an assignment of life insurance on the principal. The loan defaulted by 1988, and after the death of the principal, JEDA was unable to collect the 50% guarantee. JEDA charged off a loan balance of $600,537 after selling the collateral obtained following the default.

Loan 2

In 1990, JEDA was asked to participate in a "trade finance transaction" involving a loan to a clothing manufacturer. The company was in debt in excess of $10 million. JEDA provided $500,000 in order to finance inventory purchases of winter clothes which were to be sold to various U.S. retailers. The credit request report prepared by JEDA describes the transaction as "fully collateralized" by the merchandise to be purchased. JEDA did not require any personal guarantees on the loan.

The loan defaulted, and JEDA charged off a loan balance of $85,191 indicating that the loan was not, in fact, fully collateralized. Our review of the file indicated that a substantial amount of staff time and resources were required in order to sell the merchandise.

During the negotiation process with the company, state law was changed to exempt all greenhouses from property taxes in order to lure this business to South Carolina. Losses because of this change are approximately $500,000 annually.

Loan 3

In 1990, JEDA made a $500,000 CDBG loan to a start-up agricultural business which later defaulted. A total of $463,105 was charged off in 1993. In the weeks prior to the loan closing, the president of the corporation resigned his position in the midst of public disclosure concerning his conviction of drug-related crimes in Europe and returned all of his stock back to the corporation. Therefore, his personal guaranty was no longer available to JEDA. However, JEDA did obtain the corporate guaranty of a company located in Central America.

During foreclosure proceedings against the company, contacts in Central America reported that the address given for the corporation did not exist, and it was their opinion that the corporation was a "ghost company."

An interesting point regarding this loan was that during the negotiation process with the company, state law was changed to exempt all greenhouses from property taxes in order to lure this business to South Carolina. The South Carolina Department of Revenue estimates that the current revenue losses because of this change are approximately $500,000 annually. Therefore, actions taken to bring about this transaction continue to cost the state annually in the form of lost revenue.

Loan 4

In 1985, JEDA made a $250,000 CDBG loan to a company. Part of the transaction involved one of JEDA's board members conveying his interest in approximately eight acres of property located in an industrial park to JEDA. In response to our inquiries, JEDA officials stated that the land transferred to JEDA only served to provide additional collateral to better secure the loan. After the loan defaulted, JEDA charged off the loan balance of $209,060 in 1989. Prior to the charge-off, JEDA sold the parcel of land back to the board member for $5,000. We have not been able to determine why JEDA's loan committee would allow a board member to convey his personal property to JEDA as collateral for a loan. We do, however, doubt the appropriateness of the transaction.

In addition, CCIC made a $25,000 "venture capital" loan in 1986 to the same company and did not require any collateral to secure the loan. Instead, a complex partnership arrangement was proposed where CCIC and a company employee would loan money to the business in exchange for ownership in the company. However, the business failed shortly after the CCIC loan was made. Correspondence in the loan file from CCIC's attorney who prepared loan and partnership documents for this transaction stated "From the beginning, I advised everyone that the transaction was too complicated for the amount of money involved. A routine secured loan would have been much simpler, safer, and less costly . . . ."

It is inappropriate for a board member to personally guarantee bank notes in order to provide a loan to a business in a state-sponsored program.

Loan 5

In 1984, in order to assist a failing textile business, a credit line of $100,000 was established at a local bank by one of JEDA's ex Officio board members, who personally guaranteed the transaction. These funds were made available to CCIC (formerly JOBEC) and CCIC, in turn, loaned the funds to the business. The financial outlook of the business continued to decline, and a year later another bank loan was obtained by CCIC in the amount of $100,000 which again was personally guaranteed by the same board member. The proceeds from this loan were also loaned to the business.

Meanwhile, JEDA received a $1 million state appropriation which was transferred to CCIC by January 1986 (see further discussion on p. 42) thereby giving CCIC the financial autonomy to remove the personal guarantee of the board member. According to CCIC's loan portfolio analysis, a total of $400,000 was loaned to this business. However, the loan defaulted and CCIC charged off $134,119. It is inappropriate for a board member to personally guarantee bank notes in order to provide a loan to a business in a state-sponsored program.

Recommendation

19 JEDA and CCIC should implement policies which more specifically define the terms of loan collateralization and personal guarantees, in order to ensure compliance with §41-43-150(C)(6) of the South Carolina Code of Laws concerning the protection of the public's interest when making loans to businesses.

Leveraging of Private Funds

We reviewed CCIC's lending policy and found that CCIC has no limit on the percent of a total project's cost that can be funded under its commercial loan program. Of the 30 loans made by CCIC as of October 31, 1994, we found 13 cases (43%) where CCIC funded 100% of the project's cost. We found an additional four cases where CCIC funded more than 40% of the project's cost.

We found 13 cases (43%) where CCIC funded 100% of the project's cost.

According to CCIC's lending policy, its loans are intended to be made in conjunction with private lenders who want to limit their exposure. JEDA's lending policy for its CDBG program states that the amount of CDBG assistance shall not exceed 40% of a project's cost. Overall, we found that for every $1 of CDBG funds JEDA leveraged $3.45 of private money. For every $1 of CCIC loans, $1.67 in private financing was leveraged.

State government should not provide a major part of the new capital needed, and should not replace the role played by private financial institutions. CCIC needs to use its funds as a stimulus to generate private financing for projects which would not have been undertaken otherwise.

Recommendation

20 CCIC should establish a limit on the percentage of a project's total cost it will fund.

Use of Loan Proceeds

In our sample of 16 CDBG loans, we found a current loan where the borrowers may have spent loan proceeds inappropriately. JEDA's governing statutes state:

> Proceeds of loans under this section are utilized: (i) to acquire . . . land and buildings . . . machinery, equipment, office furnishings . . . or for research and design costs, legal and accounting fees . . . or (ii) for the research, testing, and developing of new products, machinery, equipment . . . and the initial marketing thereof. Loan proceeds also may be used to finance working capital [§41-43-160].

In 1986, JEDA made a CDBG loan to a business in the amount of $135,000. According to the loan agreement, the loan proceeds were to be used ". . . for, and only for, the purposed acquisition of capital assets." However, correspondence found in the loan file written by the borrower's attorney indicated that the purpose of the JEDA loan was to help settle a lawsuit against the business filed by its minority stockholder.

According to correspondence found in the file, JEDA was aware the loan funds were to be disbursed by the borrower's attorney as follows.

Use of Loan Proceeds	Amount
Final Payment to Settle Lawsuit	$115,000
Pay-off Lease Purchase Agreement of Automobile	$3,221
Remainder Paid to Business	$16,779
Total	$135,000

The first two items do not represent capital assets. Using a loan to pay off a lawsuit appears to violate JEDA's statute regarding appropriate use of loan proceeds.

Recommendation

21 JEDA should ensure that loan proceeds are used in accordance with statutory requirements.

Conflict of Interest

JEDA's policy on ethical conduct is inadequate and CCIC by-laws do not contain a statement on ethical conduct. Also, JEDA has not established a formal process to implement its ethics policy.

JEDA's by-laws contain a provision which prohibits considering loan applications where ". . . any Board member or any member of his immediate family (to include his/her spouse, their parents, their children, and their respective spouses) has a financial interest."

This ethics statement was adopted by the JEDA board on October 24, 1990. Board minutes from prior meetings show that the original language proposed included staff members as well as board members. It appears that "staff" was deleted from the final version approved by the board. The staff should be included in the statement in order to avoid favoritism, or the appearance of such, in any of JEDA's loan programs. In addition, HUD regulation 24 C.F.R. §570.489(h)(3), which prohibits conflicts of interest in its CDBG programs, states that the persons covered include employees of the state or unit of local government.

The staff should be included in the statement in order to avoid favoritism, or the appearance of such.

Prior to the adoption of the ethics by-law, there were situations where board members were involved with loan recipients. In two instances, a board member personally provided either collateral or a personal guarantee for the loan. In both cases we were unable to determine a connection between the board member and the business. Another case involved a bond to a partnership in which a board member was a partner in the business.

The integrity of small business loan programs may be compromised if even the appearance of favoritism is present. Therefore, a comprehensive policy to identify potential conflicts of interest may be necessary. This policy could include the development of internal guidelines for polling board and staff members to determine whether they are related to loan applicants.

After JEDA reviewed our draft report, the board on May 18, 1995, amended their ethics policy to include staff members in its provisions. They are in the process of amending their by-laws.

Recommendations

22 JEDA should include staff members in the provision in its by-laws which prohibits the consideration of loan applications of parties related to board members. JEDA's policy could include guidelines for polling board and staff members.

23 CCIC should amend its by-laws to include a statement on ethical conduct similar to that found in JEDA's by-laws.

Administrative Issues

This chapter addresses administrative and management issues. These include possible statutory violations where state administrative funds have been used to capitalize CCIC's revolving loan fund. In addition, we found administrative overcharges made by both JEDA and CCIC. Some expenditures may be unnecessary. We found problems in a contract for lobbying and a strategic plan, in CCIC's lack of a written investment policy, and in policy for recordkeeping and retention.

As previously noted, JEDA continues to receive state funds even though the Governor recommended in 1992 that they be phased out within two years. In FY 94-95, JEDA received $125,000 in general funds and is budgeted to receive this amount again in FY 95-96. These funds are not appropriated directly to JEDA but instead are appropriated to the State Budget and Control Board's Division of Local Government which then transfers the funds to JEDA.

Use of State Appropriations

JEDA has used state appropriations not spent on administrative expenses to capitalize CCIC's revolving loan fund (RLF). This may be a violation of JEDA's enabling legislation. Also, JEDA should have used these funds to meet federal matching requirements for administrative expenses rather than continuing to receive state appropriations. We estimate that JEDA used $583,000 in state appropriated funds not spent on administration to capitalize CCIC's revolving loan fund.

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Section 41-43-50 states, "The authority shall retain unexpended funds at the close of the state fiscal year . . . and expend the funds in subsequent fiscal years." Section 41-43-20(c) defines administrative funds as "all monies, received by the authority from the general fund of the state . . . which are designated specifically to be used for payment of administrative expenses." Evidence indicates the state appropriated funds were for administrative purposes. Also, §41-43-220 of JEDA's enabling legislation states, "The authority must not incur any obligations, other than obligations related to administrative expenses, payable out of administrative funds. All other obligations are payable solely from program funds."

In FY 92-93 and FY 93-94 JEDA received $762,000 in state-appropriated funds. We estimate $179,000 was used to fund operating costs. The remaining $583,000 was placed in CCIC's loan fund. As of January 31, 1995, CCIC had a cash balance of $888,500.

JEDA may be violating its statute by allowing CCIC to use state appropriations meant for administrative expenses to fund business loans. In addition, JEDA continues to receive state appropriations when it should have used the unexpended state funds from FY 92-93 and FY 93-94.

Recommendations

24 JEDA should require CCIC to return to JEDA state appropriations used to fund CCIC's revolving loan fund.

25 JEDA should use cash balances to meet its federal matching requirements for the CDBG program.

26 The General Assembly may wish to consider requiring JEDA to repay the state's general fund the $125,000 appropriated in FY 94-95 for the purpose of funding JEDA's operations.

27 The General Assembly may wish to consider deferring JEDA's state appropriations for FY 95-96 and subsequent years until the remaining state appropriations from FY 92-93 and FY 93-94 have been expended.

Administrative Charges

Under the CDBG program, a local government receives a grant from JEDA's CDBG revolving loan fund which in turn is loaned by the local government to a company. In order to recover its administrative costs associated with making the loan to the company, CCIC charges the local government an administrative fee based on a percentage of the loan. This fee is designed to cover the up-front costs associated with making the loan. CCIC also receives a separate monthly fee to cover ongoing loan servicing costs.

In September 1993, HUD reviewed the administrative fee structure used by CCIC to recover its administrative costs and found that CCIC was not adequately documenting its charges. CCIC hired a consultant (Williams, Adley & Co.) to determine the appropriate administrative fee structure. We reviewed the administrative fee structure between JEDA and CCIC and found it has not correctly accounted for the administrative costs of the CDBG program.

First, we found that the consultant included the salaries and benefits of two JEDA employees as a CCIC cost. However, during our review, we found that CCIC did not actually pay the costs associated with the two JEDA employees. As a result, CCIC recovered $204,589 more than it was entitled to from the CDBG revolving loan fund.

CCIC recovered $204,589 more than it was entitled to from the CDBG revolving loan fund.

Second, we found the consultant hired by JEDA/CCIC improperly included the costs of loan servicing in the administrative charge for the up-front costs. Thus, loan servicing costs were paid twice, once as part of the up-front fee and again when CCIC collected its monthly loan servicing fee. We estimate that CCIC recovered from CDBG funds approximately $74,000 more than it was entitled to for these costs.

Third, we found that CCIC also improperly paid for operating costs associated with the two JEDA employees. These operating costs, (rent, telephone, automobiles, etc.) were included as part of CCIC's up-front costs and amounted to approximately $67,000. However, these costs should have been paid by JEDA from administrative funds.

During the course of our review, JEDA officials stated they intended to refund the CDBG RLF for the excess cost recovery associated with these items.

Administrative Cost for Loan Programs

We also found administrative overcharges in two other loan programs we reviewed. JEDA did not properly account for the administrative costs associated with the Minority Loan Program (MLP). The MLP was created to help small and minority businesses expand using CDBG funds. Under a contract that ended in May 1992 with Division of Economic Development in the Governor's office, JEDA was to help review loan applications and service the loans. JEDA was to provide DED with an accounting of all costs incurred no later than September 30 of each year, as well as at the end of the contract, and would be reimbursed for costs up to $75,000 for the contract period of April 1990 through May 1992.

In April 1991, DED approved JEDA's request to use MLP funds to pay for various general expenses, even though, according to HUD officials, CDBG funds should only be used to pay for actual, documentable expenses associated with the CDBG program. Three loans were made under the program totalling $260,000. JEDA received the entire $75,000 in administrative funds. Effectively, JEDA charged an administrative rate of 29%, compared to CCIC's 1992 rate of 12.5%. This is $42,500 more than CCIC would have charged.

JEDA's administrative charges under the PBBF program are also questionable. Loans to construct buildings under the program are funded using a 50/50 match of Economic Development Administration (EDA) and CDBG funds. JEDA collected an administrative fee of 12.5% of the CDBG loan amount, totalling approximately $50,000. Based on the study done by JEDA's consultant, we estimated that JEDA's actual costs for administering the program were about $37,330. Thus, it appears JEDA may have collected $12,000 more than it actually cost to administer the program.

Payment of Fees

CCIC has not received all fees due under the management and servicing agreement between CCIC and JEDA. From July 1992 through February 1995, we estimate CCIC was owed approximately $161,000 by JEDA.

Under Article 8 of the management and servicing agreement, CCIC agreed to perform the duties associated with issuing IDBs as well as other duties. In exchange for CCIC performing these functions, JEDA agreed to pay CCIC all compensation JEDA received for these services. Article 10 of the agreement states that the agreement can only be modified in writing. However, there was no written amendment to the management and servicing agreement, and CCIC has not received a total of $161,000 that it should have received. This results in less money available for CCIC to loan to businesses. CCIC is also essentially performing services for JEDA free of charge.

Recommendations

28 JEDA/CCIC should review administrative charges for the CDBG program to ensure that they are appropriate.

29 JEDA/CCIC should reimburse the CDBG revolving loan fund for any administrative overcharges.

30 JEDA should review its administrative charges for the Minority Loan and Palmetto Basic Building Fund program. If the actual administrative costs for the programs do not amount to the amount of funds received, JEDA should reimburse the proper entities for the difference.

31 JEDA should pay to CCIC all fees due under the management and servicing agreement.

32 Any modifications to the management and servicing agreement should be performed in writing as required by the agreement.

Miscellaneous Expenditures

Both JEDA and CCIC are public agencies, using public funds, and were created for a public purpose. We reviewed both JEDA's and CCIC's expenditures for appropriateness as to public purpose, concentrating on travel, club memberships, benefits, and miscellaneous purchases over a four-year period from FY 90-91 through FY 93-94. While our review of these expenditures did not find infractions of state requirements, we identified some purchases which might be an unnecessary or wasteful use of public funds.

- The JEDA and CCIC boards in April 1994 held a two-hour board meeting in Charleston and also toured two agricultural facilities there which received CDBG loans. Total cost for the 14 board members and staff was about $6,735, including $1,049 for a dinner cruise, $2,739 for hotel, $1,035 for transportation in the Charleston area and $1,912 for mileage, per diem, and other meals. These expenses were paid from both JEDA and CCIC accounts.

  The cost for the dinner cruise exceeded the state's $20 a day in-state meal allowance. In addition, alcoholic drinks were purchased as part of the dinner cruise; according to the comptroller general's office, while it is not a written policy the state normally does not pay for the purchase of alcoholic beverages.

- CCIC pays dues and meal costs for JEDA's executive director's membership in the Capital City Club, for a total of $5,901 for the four-year period. CCIC also pays dues and meal costs for JEDA's executive director's membership in the Rotary Club, amounting to $660 in 1993 and 1994. Economic development agencies may need to maintain a membership in business clubs in order to meet with clients. However, membership in the Rotary Club normally would not be reimbursed by the state, according to the comptroller general's office.

- JEDA's executive director and the staff of CCIC (22) received extra disability insurance from CCIC. They also receive state disability benefits. The total annual premium for the disability insurance paid by CCIC is approximately $3,640.

- JEDA and CCIC paid monthly fees totalling approximately $5,400 for the watering and care of indoor office plants over the four-year period. They also spent $1,773 during this time for floral arrangements bought for the office and for staff, board members, and family members.

Recommendation

33 JEDA should discontinue unnecessary or wasteful purchases.

Project Award and Lobbying

We reviewed payments made to lobbyists by JEDA and CCIC. Although the lobbyists were working on JEDA's behalf, they were hired and paid by CCIC.

From January through June 1992, CCIC paid The Fontaine Company $30,000 for a transition plan and $46,332 in lobbying and consulting fees. From May 1993 through June 1994, CCIC paid a second lobbyist a total of $17,000. This lobbyist currently is on a $2,000 a month retainer.

Our review found problems with the manner in which The Fontaine Company was selected, and with the "transition plan" that resulted from this project.

Scope Changed After Award

Originally, the CCIC board published a request for proposal (RFP) for a "Strategic Plan" to be developed and implemented by a management consulting firm. The strategic plan was to help JEDA clarify its objectives and to identify what programs would be needed by businesses in the state.

Four firms submitted proposals. All four proposals outlined the planning procedures that should be followed, including: formulating a mission statement, goals and objectives; surveying JEDA and CCIC staff; analyzing applicable federal and state legislation; collecting economic and financial data; and identifying needs and sources of capital, etc.

Fontaine was approved even though its bid was the highest at $95,000. The other three firms, all major accounting firms, had bids ranging from $28,600 to $91,200.

When Fontaine was awarded the project on December 23, 1991, the JEDA and CCIC boards changed the entire nature of the project. The consultant was instead directed to develop a "transition plan" to help JEDA become a self-sufficient enterprise agency. CCIC agreed to pay $30,000 for the transition plan and also authorized Fontaine to act as a lobbyist to implement the plan at a cost of $150 an hour.

CCIC was exempt from the State Procurement Code when it purchased these services. If the procurement code had applied, however, then CCIC would not have been able to change the nature and scope of the project without giving the other bidders a chance to respond.

Currently, both JEDA and CCIC have their own purchasing manual. It exempts the procurement of professional services from solicitation requirements. However, when an RFP is made, CCIC's manual states:

> . . . eligible offerors shall be afforded the opportunity to submit best and final proposals if negotiations with any other offerer would result in a material alteration to the Request for Proposals and such alteration would have a cost consequence that could alter the order of offerors' price quotations contained in their initial proposals.

Transition Plan Developed

One month elapsed between the time The Fontaine Company was awarded the bid and the transition plan was presented to the JEDA and CCIC boards.

The four-page plan called for changes in JEDA's legislation that would allow it to generate a higher level of fees from its CDBG program income. The consultant recommended specific changes in JEDA's legislation and that JEDA be made exempt from the state's personnel and procurement procedures. The transition plan did not perform most of the functions outlined in the proposals submitted to the CCIC board. In effect, it merely listed what the agency needed to lobby for in order to generate its own income.

Because the actual work produced was different than what was bid, we could not determine if the $30,000 paid for Fontaine's plan was appropriate. Changing the scope and nature of a project after it is awarded makes it difficult to ensure that the project was awarded to the most qualified bidder.

According to JEDA and CCIC officials, Fontaine's plan was successfully implemented and forms the basis for JEDA's present operations. JEDA has yet to develop a "strategic plan" that would guide its economic development activities in general (see p. 19).

Disclosure of Lobbyist Expenditures

CCIC also paid The Fontaine Company $46,332 for lobbying and consulting fees from January 1992 through June 1992. In CCIC's "Lobbyist Principal Disclosure Statement" covering the nine months from January through September 1992, it reported total lobbying expenditures of only $15,079. Board minutes from January 22, 1992, state, "The Fontaine Company would act as a lobbyist to get the essential legislation passed at a cost of $150.00 per hour." We could not determine what portion of the $46,332 paid to Fontaine in getting JEDA's legislation passed could be attributed to actual time spent lobbying members of the General Assembly.

Section 2-17 *et seq.* of the South Carolina Code of Laws on lobbyists and lobbying was amended effective January 1992. The law requires a lobbyist's principal (such as CCIC) to report all income paid to lobbyists.

CCIC did report the entire $17,000 paid to a second lobbyist within the past two years.

Recommendations

34 When it needs to acquire consulting services in the future, JEDA should ensure that CCIC follows the policies in its purchasing manual.

35 CCIC should accurately record and report the amounts it spends on lobbying.

Criteria for Loan Administrator

JEDA has not established written criteria for loan administrators. In addition, JEDA does not inform borrowers in writing that they may use an administrator other than CCIC. Section 41-43-160 states that JEDA shall, "Require as a condition of each loan made . . . that the loan must be serviced by a loan administrator which meets criteria established by the authority. "

According to JEDA officials, no written criteria have been established. In instances where a borrower wants to use a loan administrator other than CCIC, JEDA would examine the loan administrator to ensure the entity is capable of performing the administrative functions. Also, according to JEDA officials, JEDA does inform local governments that they may choose a loan administrator other than CCIC. However, this is not done in writing.

Recommendation

36 JEDA should establish, through regulation, criteria for loan administrators.

Recordkeeping

According to §41-43-150, when approving loans JEDA is ". . . entitled to rely upon its own investigation or upon such information and evidence furnished to it by recipient businesses . . . as the authority considers appropriate."

Over the years, JEDA has developed various loan and bond guidelines and policies which outline the required documentation to be submitted by applicants to its programs or to be developed by the authority's staff. We reviewed selected files for the CDBG loan program, the CCIC loan program and the industrial revenue bond program for compliance with internal policies regarding file documentation. In addition, we reviewed and utilized several reports prepared by JEDA in connection with its programs.

Documentation in Loan and Bond Files

Since HUD periodically monitors the CDBG program, some external oversight of loan documentation does exist for this program. Therefore, our review of the CDBG loan files was not as detailed as our review of the CCIC files regarding specific documentation. The CCIC loan program has no in-depth external review (except independent financial audits) regarding loan documentation and compliance with internal lending policies. JEDA's role in the bond program, for the majority of cases, does not include an evaluation of the creditworthiness of the borrowers. However, JEDA does require some documentation from the borrowers, primarily to determine if the project is viable. We found several instances of inadequate documentation in CCIC loan files and in bond files. In addition, we found that one bond file was missing.

Lack of Proper Documentation in CCIC Loan Files

In our sample of 12 CCIC loan files we found 2 files that did not contain evidence of a complete credit analysis based on required documentation. For one, no credit write-up was prepared. The second loan file did not contain borrowers' financial information to be used for a credit analysis. This loan eventually was charged off in the amount of $134,119. CCIC's lending policy states that potential borrowers must submit extensive information to CCIC including historical and projected financial information for the business, personal financial statements of the principals, and a description of projected job creation or retention. This documentation is used by the lending staff to evaluate the creditworthiness of the applicants.

Bond Files Incomplete

While JEDA is not responsible for analyzing the creditworthiness of all participants, the underwriting criteria for the bond program require each company to provide documentation concerning the project to be funded. Examples of information required are an accounting of project costs, a market analysis, a business plan and job creation projections. In a sample of 27 bond files reviewed, 17 (63%) had missing documentation. This includes 12 that were lacking enough documentation to determine the outcome of the project, whether it was being monitored, or whether the bonds were still in force. Also, one application file for a company that had received a bond was missing.

No Central Record of Collateral Seized by JEDA

We found that JEDA does not maintain a central inventory of assets that have been recovered when a business defaults on a loan. Section 41-43-230 of the South Carolina Code of Laws states, "The authority may dispose of any property acquired by it on terms and conditions considered appropriate. The authority is not required to advertise property or take bids thereon."

Therefore, JEDA has sole discretion in the handling and disposition of these assets. During our review of charged-off loans, we found several instances where JEDA had taken title to certain assets including a factory (land, building and contents), inventory consisting of winter clothing, and a parcel of land once belonging to a JEDA board member. We were informed by JEDA officials that information concerning these assets is found only in the individual loan files and not in one central place. Good business practices dictate that in order to better safeguard such assets and maintain better accounting controls over them, JEDA should keep a central inventory (listing) of assets which they have seized. This listing should specifically identify the assets, give the location and approximate market value of the assets and the intended disposition.

Loan Portfolio

We found misleading information on JEDA's Loan Portfolio Analysis report. This report contains basic information concerning each loan and is used to update the outstanding loan balances each month. This report is used by the independent auditor in evaluating JEDA's loan receivable balance, and information from this document is provided to JEDA's Board of Directors.

During our review of the CDBG asset securitization (see p. 15), we noted that many of the loans listed in the paid off category are loans which were part of the securitization transaction. However, there is no notation on the portfolio which identifies these loans as such. This lack of information, in our opinion, distorts the portfolio. Without any additional information, a user of this report may assume that all loans in the paid off category were fully paid off in accordance with the loan terms, or were paid off earlier than anticipated. In reality, the majority of these loans have not been paid off. They have simply been moved to another loan portfolio which CCIC manages for the purchaser of the loans. Due to the number of users of this report, it is important that it contain reliable, consistent information.

Recommendations

37 JEDA should institute quality control measures to ensure that adequate documentation is included in all loan and bond files.

38 In order to better safeguard assets and maintain better accounting controls over them, JEDA should maintain a central inventory of assets which they have seized.

39 JEDA should indicate in its CDBG loan portfolio which loans were sold as part of the asset securitization transaction.

Records Retention

Records of the Carolina Capital Investment Corporation are not archived with the Department of Archives and History, in accordance with Title 30, Chapter 1 of the South Carolina Code of Laws, which governs the retention of public records. While records transmittal forms from Archives indicate some retention of CCIC correspondence, we found no documentation relating to the corporation's financial and loan transactions.

The records officer for both JEDA and CCIC has informed us that both agencies previously followed the same retention schedules; however, new retention schedules will be developed for CCIC. In addition, the management and servicing agreement entered into between JEDA and CCIC states that CCIC's records are the property of JEDA.

Retention of Denied Applications

JEDA does not retain information on applicants who have been denied federal CDBG funds. According to a JEDA spokesperson, there is not enough office space to keep all the applications received. The federal government requires this information as a means of determining compliance with uniform program administration requirements.

Federal regulations for FY 93-94 governing the CDBG program require states to submit data to HUD concerning the racial, ethnic and gender characteristics of those who apply for, participate in, or benefit from CDBG funding (24 C.F.R. §570.491). A spokesperson for the regional office of HUD stated that data on all applicants for CDBG funds, including those who were denied, should be retained for three years. A review of denied applications would be necessary in determining if JEDA has complied with federal law. According to a spokesperson for the Division of Economic Development, JEDA did not submit complete civil rights data for FY 93-94. If HUD decides to enforce the requirement, JEDA may be found in noncompliance.

Furthermore, §41-43-150 of the South Carolina Code of Laws prohibits discrimination in the administration of its programs. Information related to applicants who have been denied funding for any of JEDA's programs is necessary to determine if the authority is in compliance with its statutes.

Recommendations

40 JEDA should ensure that records of CCIC are archived in accordance with Title 30, Chapter 1 of the South Carolina Code of Laws.

41 JEDA should retain in its files for at least three years applications for program funding which have been denied.

Freedom of Information Act

Both JEDA and CCIC do not give public notice of their loan committee meetings. Loan committee meetings are held monthly, or more often if necessary, to make decisions on potential loan contracts. In addition, meeting minutes reflect that both the JEDA and CCIC boards have taken action during executive session, in violation of the Freedom of Information Act (FOIA).

While both JEDA and CCIC boards comply with this requirement, their loan committees do not.

Section 30-4-80 of the FOIA requires that all public bodies give at least 24 hours written public notice of their meetings. While both JEDA and CCIC boards comply with this requirement, their loan committees do not. We found documentation that an attorney acting as bond counsel for one of JEDA's transactions brought this issue of noncompliance to the attention of JEDA in April 1993. However, according to a JEDA official, loan committees still do not give public notice of their meetings.

Section 30-4-70 prohibits a public body from voting in executive session. We reviewed minutes of JEDA and CCIC board meetings from 1990 through 1993. We found four instances in which the JEDA board, during executive session, approved decisions of its loan committee and ratified these actions upon returning to open session. While the FOIA previously allowed a public body to take formal action in executive session and ratify the action in public session, the law was amended in 1987 to prohibit this.

Section 41-43-60 of the South Carolina Code of Laws permits telephonic meetings of JEDA's board. A review of both JEDA and CCIC loan committee minutes from January 1991 through December 1993 shows that a majority of meetings during that period, 90% and 78% respectively, were telephonic.

Recommendation

42 JEDA should ensure that FOIA requirements governing meetings are complied with by its own board, CCIC, and committees of either entity.

Written Investment Policy

CCIC has no written policy concerning the investment of funds. According to JEDA officials, the Board of Directors has, over the years, discussed various options and has always selected conservative investments. Currently, CCIC has eight bank accounts and two certificates of deposit. We found that three of the checking accounts can probably be closed due to lack of activity. Two of these accounts had no activity besides bank charges and interest income for FY 93-94.

The assets of an organization, including cash, must be properly safeguarded by a system of internal controls. Appropriate internal controls would include the establishment of written policies directing the investment of cash. Written policies serve to clarify the specific objectives of management as well as direct the actions of staff.

While we did not find any improprieties relative to the bank accounts, monitoring numerous accounts, including those with little or no activity, can be difficult. Unnecessary accounts should be eliminated to facilitate proper supervision of funds.

Recommendations

43 CCIC's Board of Directors should establish a written investment policy.

44 CCIC should close bank accounts which have had little activity and are unnecessary to normal operations.

Possible Alternative Investment Option

The Office of the State Treasurer has an investment pool in which local governments invest public monies in excess of current needs. According to documentation provided by the treasurer's office, the pool has been earning between 3.23% and 5.89% over the past year. In addition, the pool allows participants access to their funds within one day.

As of March 1995, bill No. 26 has been introduced in the Senate (and was referred to committee) which would amend §6-6-10 of the South Carolina Code of Laws to allow non-profit entities which provide contractual services to state agencies to participate in the investment pool of the state treasurer's office. It appears that this bill, if passed by the General Assembly, would allow CCIC access to the investment pool.

Recommendation

45 CCIC's Board of Directors and management should consider investing in the investment pool maintained by the Office of the State Treasurer, if authorized by law to do so.

Issues for Further Study

During the course of this audit we found several issues for further study. JEDA is part of the overall economic development program of the state; from this perspective, there are issues directly concerning JEDA which extend beyond the agency.

Gaps in the State's Capital Markets

Governor Riley and the Coordinating Council on Economic Development commissioned a study in 1985—*Capital Markets and Economic Development in South Carolina: New Directions for State Policy*. This study found that South Carolina was indeed a capital poor state.

Since then, South Carolina has made progress in plugging some of these "capital gaps" through the creation of new programs. For example, the Palmetto Seed Capital Corporation was created by state statute to supplement conventional financing for growth-oriented businesses. EDI is another program that spun-off from the Department of Commerce in 1989, and its mission is to identify and help develop resources for businesses and economic development. However, the economic development officials we interviewed in the course of this audit stated that "gaps" still persist.

According to the 1985 study, "JEDA suffers from having too broad a mission and inadequate as well as inappropriate capitalization . . . ," and a more effective gap-filling role for JEDA would be to focus on leveraging private funds. We determined that, ten years later, JEDA uses its CDBG revolving loan fund to combine with private investment for a ratio of 1:3.45. However, JEDA's direct loan programs may not be large enough to pull in the amount of private funds needed. JEDA also is hampered by HUD restrictions on the use of CDBG funds. It was beyond our scope to determine how far JEDA goes in filling the state's capital investment needs.

Another new initiative in South Carolina, the Main Street Investment Program, uses SBA loan guarantees and state deposits to encourage banks to make loans to small and start-up business. This program is a joint effort between the Office of the State Treasurer, the SBA, and the Department of Commerce. Other states, such as Mississippi and Alabama, also use state loan guarantee pools and linked deposits as strategies to leverage and/or buy down the cost of private financing. This may use limited public resources more effectively than a direct loan program. A fundamental goal should not be to replace private investment with public funds, but rather to stimulate private investment and financing.

Therefore, questions remain as to what capital gaps still exist in South Carolina, how far JEDA's programs can go in filling these gaps, and whether other economic development strategies being initiated in this state are more effective in leveraging private financing and targeting investment to where the greatest needs are.

Centralized Coordination of Tax-Exempt Bonds

Tax-exempt bonds are a limited resource. Federal tax laws set a ceiling amount that states can issue so as to limit federal revenue losses. The state also loses state income tax revenue. We could not determine the amount lost through the tax-exempt revenue bonds; however, total state tax losses over a three-year period for all tax-exempt bonds (this includes revenue bonds as well as general obligation) are estimated at $104,821,000.

As previously noted JEDA is not the only entity which has the ability to issue tax-exempt revenue bonds. The State Housing and Development Authority, the State Education Assistance Authority, and all South Carolina counties also can issue tax-exempt "private activity" bonds which must be allocated under the state ceiling or volume cap. Section 1-11-510 to 520 of the South Carolina Code of Laws requires the Budget and Control Board to make these allocations. Generally, 60% of the tax-exempt revenue bonds available under the state volume cap is set aside for counties; 40% for state-level authorities. The State Budget and Control Board has the authority to shift unallocated funds from one group to the other. According to JEDA officials, available funds are then allocated on a first-come, first-served basis.

In view of this, state-level priorities may need to be set on the use of tax-exempt revenue bonds that are allocated under the state ceiling. We found that the IDBs issued by JEDA are not well-suited to meet key economic development goals such as job creation and investment in poor counties. State allocation policy should be reviewed to ensure it best serves the overall economic development needs of the state. Furthermore, JEDA has moved away from the role envisioned for its bond program—that of pooling the capital needs of smaller companies into a single bond issue. The feasibility of and need for this kind of financing needs to be studied.

Recommendations

46 The Department of Commerce, in conjunction with new statewide strategic planning initiatives, should consider what capital gaps still exist in South Carolina, how far JEDA's programs can go in filling these gaps, and what other economic development strategies should be developed that could be most effective in leveraging private investment.

47 The State Budget and Control Board or the Office of the State Treasurer may wish to study setting priorities for the use of tax-exempt private activity bonds that are allocated under the state ceiling.

Appendices

Audit Scope and Methodology

The scope of our review began with the establishment of Jobs-Economic Development Authority (JEDA) and its corporate activities from 1983 through 1994, depending on our assessment of data, particularly loan information. The primary programs reviewed were: the Community Development Block Grant (CDBG) economic development loan program; the Carolina Capital Investment Corporation (CCIC) direct loan program; JEDA's tax-exempt Industrial Development Bond Program; the Palmetto Basic Building Fund (PBBF); JEDA's Export Program; and the Minority Loan Program. The primary criteria we used to measure program implementation were federal and state laws and associated regulations.

Our audit methodology included an analysis of JEDA/CCIC program records, financial data, board minutes, and policies and procedures. We interviewed JEDA and CCIC personnel as well as personnel associated with the Department of Housing and Urban Development (HUD), the Small Business Administration, the South Carolina Business Development Corporation, local government CDBG programs, the South Carolina Department of Commerce, and the Governor's Division of Economic Development. We reviewed research in the area of economic development provided by numerous state and national entities, including Council of State Community Development Agencies, the Urban Institute and the General Accounting Office.

We reviewed various internal controls in the lending and loan administration areas. In our review of JEDA and CCIC loans, we relied on sampling techniques discussed in applicable sections of the report. We chose 12 of the 16 CDBG loans in one sample from those which had been charged off as uncollectible, in order to focus on problem loans. Most charged-off loans had been originated before FY 88-89; this reflects the fact that parts of our review focus on agency actions that have occurred more than five years ago. Another sample of 24 CDBG loans was reviewed to verify JEDA's claims of job creation; also a sample of 12 CCIC loans was reviewed.

For our analysis of defaulted and charged-off loans, we did not sample but reviewed the entire loan portfolio. We also reviewed all bonds issued as of June 1994 in order to verify job creation, and reviewed a sample of 27 bond files for in-depth information. We did not review JEDA's taxable bonds as a separate program since only two or three have been issued. Two other programs, the PBBF and the export guarantee program, were reviewed extensively even though these programs have created few jobs.

However, we did not review in-depth five other JEDA programs that have either had no activity or have issued few loans:

- CDBG Microenterprise Loan Fund.
- Intermediary Relending Program.
- SCANA Development Revolving Loan Fund.
- CDBG Loan Program for Rural Communities.
- Savannah Valley Regional Loan Fund.

We relied on the work of the outside independent auditor contracted by the agency to assess the agency's major internal financial controls. During the course of our audit, we used limited computer-generated data. This data was not integral to our audit objectives and we did not therefore perform a test of the systems. We relied on third-party confirmation performed by the outside auditor regarding current loan balances. We confirmed any other items that appeared to be questionable on a case-by-case basis.

We confirmed job statistics with the South Carolina Employment Security Commission for a small sample of companies that received assistance from the CDBG and CCIC direct loan programs. When necessary in our review, we refer to five southeastern states, namely Georgia, North Carolina, Mississippi, Alabama and Tennessee.

This audit was conducted according to generally accepted governmental auditing standards.

Information From CCIC's Financial Statements[a]

	June 30 1986	(Unaudited) June 30 1987	June 30 1988	June 30 1989	June 30 1990	June 30 1991	June 30 1992	Two Months Ended August 31 1992	June 30 1993	June 30 1994
Balance Sheet										
Total Assets	$1,470,278	$1,003,503	$1,046,224	$1,162,025	$1,601,678	$1,630,183	$1,878,353	$1,881,287	$2,741,381	$3,789,534
Total Liabilities	$531,533	$4,627	$100,190	$152,842	$171,102	$120,518	$375,851	$374,555	$855,245	$1,451,193
Contributed Capital and Retained Earnings/ Fund Balance	$1,000,123 ($61,378)	$1,000,123 ($1,247)	$1,000,123 ($54,089)	$1,000,123 $9,060	$1,454,636 ($24,060)	$1,454,636 $55,029	$1,454,636 $47,866	$1,454,636 $52,096	$1,524,616 $361,520	$1,524,616 $813,725
Income Statement										
Total Operating Income	$34,139	$97,158	$78,680	$100,376	$19,441	$126,066	$94,024	$19,752	$1,213,304	$1,381,846
Total Expenses	$93,396	$78,012	$140,333	$34,789	$31,536	$20,397	$101,055	$10,241	$851,784	$929,641
Net Income After Taxes and Extraordinary Items	($59,257)	$19,146	($61,653)	$63,149	($33,120)	$79,089	($7,163)	$4,230	$361,520	$452,205
Beginning Retained Earnings/Fund Balance Prior Period Adjustments	($2,121) 0	($61,378) 40,985	($1,247) 8,811	($54,089) 0	$9,060 0	($24,060) 0	$55,029 0	$47,866 0	0 0	$361,520 0
Ending Retained Earnings/Fund Balance	($61,378)	($1,247)	($54,089)	$9,060	($24,060)	$55,029	$47,866	$52,096	$361,520	$813,725

a JOBEC Corporation was established in 1984 as a for-profit corporation. It's name was changed to Carolina Capital Investment Corporation (CCIC) in 1987, and the corporation was dissolved in 1992. In 1992 a not-for-profit corporation bearing the same name was established.

JEDA—State Funds as a Percent of Administrative Costs

	FY 90-91	FY 91-92	FY 92-93	FY 93-94
State Appropriation	$650,389	$650,262	$379,557	$383,205
Expenditures				
Personnel	$472,273	$469,142	$112,652	$69,619
Benefits	$101,335	$102,177	$21,580	$19,604
Other Operating	$207,395	$266,671	$474,850[a]	$433,727[b]
Total Administration	$781,003	$837,990	$609,082	$522,950
State Funds Lapsed	$4,028	$9,324	$13	$0
% State Funding of JEDA Administration	82.76%	76.49%	62.31%	73.28%

a Includes management fees to CCIC of $341,250.
b Includes management fees to CCIC of $344,715.

Source: JEDA Annual Reports FY 90-91 through FY 93-94, and reports of the Comptroller General's office.

SC Jobs-Economic Development Authority "Small Business" Criteria

JEDA has defined "small business" by the type of industry. Individual types of businesses within these broad industry categories may have different standards. Most businesses are considered small by JEDA's size standards. The standard for an industry is based on either number of employees (calculated by averaging the total number of employees for each pay period during the most recently completed 12 calendar months) or average annual receipts for the most recently completed three fiscal years.

INDUSTRY	SIZE RANGE
Retail and Service	$5.0 to $21 million
Construction	$7.0 to $17.0 million
Agriculture	$.05 to $5.0 million
Wholesale	No more than 100 employees
Manufacturing	500 to 1,500 employees

If a potential borrower is close to these standards, JEDA will discuss the size eligibility issue with the JEDA Loan Committee. The specific standard for a particular business may change from time to time and some exceptions may apply.

Agency Comments

South Carolina Jobs-Economic Development Authority

Charles L. Appleby, III
Chairman

July 6, 1995

Mr. George L. Schroeder, Director
South Carolina Legislative Audit Council
400 Gervais Street
Columbia, South Carolina 29201

Dear Mr. Schroeder:

Attached is the Authority's response to "**A Management and Performance Review of the South Carolina Jobs-Economic Development Authority**" conducted by the Legislative Audit Council.

We are puzzled with many of your observations. It is interesting to note that over the last eleven years the South Carolina Jobs-Economic Development Authority (JEDA) and the Carolina Capital Investment Corporation (CCIC) have been thoroughly analyzed and audited with views which conflict with yours as to our soundness and effectiveness. Those audits include:

1. for JEDA the State Auditors Office for the period of 1984 - 1991; Wilkes and Company, CPA (outside auditing firm approved by the State Auditors Office) for the period of 1992-1994.

   for CCIC Everett Adams, CPA, 1984-1987; Sharon Pate, CPA, 1988-89; Wilkes and Company, CPA, 1992-1994.

2. the Department of Housing and Urban Development (HUD) 1984 - 1993 for compliance and program performance.

3. and the McArthur Foundation, the fifth largest charitable foundation in the country (1994).

JEDA and CCIC have always received an unqualified opinion after a detailed full audit by each accounting firm. HUD states that JEDA has an outstanding record of compliance and documentation as evidenced by its recommendation for our securitization program. Chemical Securities, Inc., and Williams Adley, CPA, thought so highly of our loans and documentation that they recommended that the McArthur Foundation purchase a portion of our loans, and the McArthur Foundation agreed.

You and your staff do make some valid points in the audit, we either have corrected these points or are in the process of correcting these issues at the present time.

In regard to your Executive Summary, we would like to point out several items that we believe would be important in fairly evaluating your assessment.

- We think it is extremely important it be understood that JEDA and CCIC receives only 4% of its funding from the State of South Carolina for day-to-day operating expenses. Through the work of Governor Campbell and our legislature in South Carolina, legislation was passed several years ago that allowed us to become self-sufficient.

1201 Main Street, Suite 1750 Columbia, South Carolina 29201 803-737-0079 FAX (803) 737-0016

- In your opening statement in the Executive Summary, you stated that we significantly overstated job creations to the General Assembly and to the Governor. We take exception to this remark. In it, specifically you talked about 1,883 jobs to a company that is no longer in business and indicated that we should not have counted these jobs. As our response indicates in detail, the loan that we made to this company allowed these 1,883 South Carolina citizens to continue on the job in excess of 26 weeks (with a total payroll of approximately $10 million) at a conservatively estimated savings to the taxpayers of South Carolina of approximately $650,000. It is not uncommon for businesses to close at some point after formal opening.

- JEDA's function is to lend money to companies trying to provide or retain jobs for South Carolina citizens. All of our loan decisions are based on the financial condition of the company at the time the loan is made and also on the current economic conditions. While our record of charge-offs may be high in your estimation, let us remind you that in virtually every situation, private sector lenders involved in the deals have also underwritten the loans and provide a legitimate second perspective on our decision making.

- Also, you continue to criticize us for the way we handle our loans, documentation, underwriting, etc. yet, you indicate correctly that JEDA was able to securitize a part of its loan portfolio because of the size of the portfolio, length and accuracy of its payment history and uniformity of loan standards. During the asset securitization process, the first of any government agency in the country using CDBG monies, we were audited by HUD, an investment banking firm, an outside independent accounting firm and the charitable foundation that purchased the loans. All of the groups thought we had done an outstanding job. This securitization allowed us to leverage CDBG funds and relend them.

- Your last recommendation to the legislature is that they may want to consider bringing JEDA under the Department of Commerce. We feel strongly that JEDA should continue to be an independent agency for the following reasons; (a) as referenced in number one above, JEDA receives only 4% of its funding from the State of South Carolina, therefore, for all practical purposes it is a self-sufficient agency of state government; (b) the present structural arrangement between JEDA and its subsidiary corporation, CCIC, was approved by the Department of Housing and Urban Development after great deliberation and is deemed essential to JEDA's ongoing ability to remain self-sufficient; (c) additionally, the agreement that HUD officials approved involves the all critical lending area. Again, any significant statutorial change would greatly impair JEDA's ability to make loans and guarantees utilizing HUD's Community Development Block Grant monies. As of May 31, 1995, JEDA has loaned $57,386,040 using Community Development Block Grant program funds. Therefore, JEDA's ability to remain independent is critical to maintaining its self sufficient status, protecting an all important revenue source for economic development lending and to making sound lending decisions without direct political influence. JEDA as the state's bank for economic development is a strong team member in the overall statewide economic development effort for South Carolina. Not all economic development agencies operate under the auspices of the Department of Commerce, nor should they. More important is how they function as a member of the team and it should be noted that we participate as a full member of the Coordinating Council for Economic Development.

We hope that you will do us the courtesy of providing a copy of this letter, along with our complete response, to anyone who would receive a copy of your report.

Further, Elliott Franks and I would welcome the opportunity to discuss any of the LAC audit with you in the hopes that there may be parts of it that we can agree are not appropriate and should be taken out or revised accordingly.

Sincerely,

Charles L. Appleby, III, Chairman

AGENCY COMMENTS

RESPONSE TO EXECUTIVE SUMMARY (Page i)

1 JEDA's involvement, as with any other lender, is not a guaranty that the business will succeed. JEDA makes every effort to protect existing jobs by offering below market rates and favorable terms which is consistent with the designed use of the CDBG loan funds. Since this is an inherently risky program, business closings are inevitable. Nonetheless, without JEDA's assistance, the specific company cited by the LAC would have closed six months sooner, thus JEDA did in fact retain those 1,883 jobs.

While this loan resulted in a loss of $85,000, it saved the state a minimum of $642,568 in unemployment and related benefits. **(SEE EXHIBIT I)** JEDA has always projected the job creation number when other government agencies have used CDBG dollars on the same projects. **However, we cannot control nor dictate job counting procedures for other government entities where funds other than CDBG are involved**. JEDA has already implemented new procedures for the counting of all jobs and will reduce it to writing without delay.

LAC failed to mention that the HUD report reviewed was an audit finding of a **documentation error only.** The HUD audit cited the need for documentation stating JEDA's assistance was required to prevent the closure of the business. **The finding did NOT question whether or not JEDA's assistance in the project was required as the LAC incorrectly states.** LAC also failed to mention that the corrective action JEDA took to prevent the inadvertent omission of supporting documentation in future loans cleared the HUD finding. See the attached excerpts from a 1990 letter issued by HUD clearing JEDA of this exception. All job retention loans made since the audit finding contain such documentation.

We find it curious that the LAC feels the number of jobs created "has little value in determining the effect of JEDA's programs on client businesses and on the economic welfare of South Carolina citizens" yet criticizes JEDA harshly for its method of record keeping of jobs created.

2 Legal counsel has opined that the Authority has not violated its statute and by-laws. This procedure is consistent with financial practices of corporate lending institutions and is not inconsistent with the Authority's enabling legislation.

JEDA's Loan Committee consists of five of the eight Board members and, when convened, constitutes a majority of the Board of Directors. No Loan Officer at JEDA can approve loans; however, the Board of Directors authorized the CEO and the COO to approve loans up to a certain level. There is no violation of JEDA's statutorial mandate. **(SEE EXHIBIT IV)**

3 We agree with the LAC's comment because we are a "niche" lender and we assume a greater risk than conventional lenders. The reason that we assume these risks is due to the economic benefits that accrue to the state. Deferment, as a practical matter, is a routine course of action in the banking industry to assist a company whose cash flow may be temporarily impaired. Relative to the increase, it is in direct proportion to the growth in the portfolio. The charge-off numbers posted by other in-state economic development entities are misleading. The Small Business Administration (SBA) and the Business Development Corporation (BDC) are unlike JEDA in that their primary position is protected, the SBA via its first lien on collateral and the BDC through its guarantees provided by the SBA. The COGs are relatively new to the lending arena, consequently, most of their portfolios are still in their infancy and too early in the lending process to accurately measure their charge off rates.

4 Measures such as job quality, targeting specific industries, helping distressed counties and small businesses, and quality of service are important to JEDA's program outcomes. Section 41-43-90 states that JEDA "**may**" collect and analyze economic development information and is not mandated. However, JEDA, because of its limited resources, focuses on lending and utilizes such entities as Research and Statistics and the research capabilities of the Department of Commerce. JEDA establishes, to the contrary, goals and performance measures each year. They are established by the staff and presented annually to the Board of Directors for approval. JEDA's methodology with regard to the implementation of new programs has not been disjointed; however, carefully planned. The more diversity an entity has in its lending arsenal, the more creative and flexible it can be in structuring a transaction to fit a company's needs. Below are examples of some of the programs created and why:

Palmetto Basic Building Fund (PBBF) - This program was developed by JEDA in an attempt to assist rural areas in the state devastated by Hurricane Hugo. The program was designed so that speculative buildings could be built in those areas to assist economic development professionals in attracting industry to these areas. Funds for the program were provided by EDA and HUD and financed the construction of five (5) of the six (6) speculative buildings in the following rural counties: Lancaster, Marion, Chester and Darlington. At the inception of the PBBF program, the national objective required by HUD was urgent need. During the program tenure, the requirement was changed from "urgent need" to job creation. HUD defines the National Objective "Urgent need" as **"if the unit of general local government certifies, and the state determines, that the activity is designed to alleviate existing conditions which pose a serious and immediate threat to the health or welfare of the community which are of recent**

origin or which recently became urgent, that the unit of general local government is unable to finance the activity on its own, and that other sources of funding are not available. A condition will generally be considered to be of recent origin if it developed or became urgent within 18 months preceding the certification by the unit of general local government".

SCANA Revolving Loan Fund - This program is an excellent example of the public-private relationships that former Governor Campbell applauded. SCANA, heavily involved in economic development, sought to create a revolving fund to leverage its resources more efficiently. SCANA approached JEDA about managing and administering this fund as they were not in the lending business. SCANA capitalized the fund and designated its target markets, primarily, its rural South Carolina service area.

Intermediary Relending Program (IRP) - This program is funded by the former Farmers Home Administration (FmHA). This program targets small businesses in the rural areas of South Carolina. The maximum level of participation on any one transaction is $175,000 and the business must be located in an area whose population is **25,000** or less.

5 To date JEDA, through all of its programs has been involved in all but one historically economically distressed county (Lee) and a loan has been approved but not yet closed in that county. Furthermore, JEDA has obtained labor force data as compiled by the Employment Security Commission and reviewed its CDBG lending activity through 1992 with the following results. Of the 152 CDBG loans made during that period, totalling over $43,000,000, 44.46% of the dollars loaned benefitted 21 historically distressed counties. **JEDA's lending activities have served distressed areas of the state. (SEE Exhibit II)**

6 JEDA has developed its definition of "small business" and will adopt it at its next scheduled board meeting.

7 JEDA could not determine the method of calculation used by the LAC. Contrary to the LAC report, an examination of the 88 bond issues reveals the following: 3,776 jobs were anticipated to be created; while 6,405 jobs were actually created. JEDA believes the cost per job reported by LAC is inaccurate. The aggregate bond dollars issued is $477,141,000. When using actual employment, the cost per job is $74,495 ($477,141,000 ÷ 6,405 jobs). Unlike CDBG funds, which are generally used to fund smaller projects, IDBs are used for capital expansion which is usually much more costly. It is entirely natural for the IDB cost per job to be greater than the $25K CDBG standard due to the differences in the financing programs. If IDBs were not available, South Carolina would not remain as competitive and prospect companies would probably seek tax considerations from other states causing a loss of jobs to the state. It should be noted that the IDB program has historically been responsible for expanding existing companies and a critical incentive in bringing major companies and jobs to South Carolina. Failure to create all planned jobs by some companies is a reality of the economic environment for which JEDA should not be blamed.

8 As a result of interstate mergers the international banking expertise has been lost in South Carolina. JEDA is the only entity that can provide international banking advice locally. By having this expertise "in-house", foreign prospects do not have to seek financial advice outside the state. JEDA's mandate to provide international related services is unique in scope compared to the domestic programs JEDA offers to South Carolina businesses, in that, the lending function for exports plays only a small part of the total international effort. LAC referenced only the documented activities which could be verified. A majority of the time was spent offering consulting services to South Carolina businesses through telephonic conferences and meetings with business representatives at various international functions in South Carolina. The consulting service is considered a very valuable activity, particularly on international banking matters, since small and medium sized banks in South Carolina do not have international banking capabilities.

The U.S. Department of Commerce, International Trade Administration's South Carolina office, as well as the Small Business Administration's, South Carolina office has no local expertise on export financing or international banking matters. Therefore, the representatives of these federal agencies refer their customers to JEDA for assistance or expertise on various international financing matters. The LAC report makes reference to the SBA and Eximbank programs which are readily available and are an alternative source for South Carolina businesses. Although both governmental agencies offer export financing services for working capital purposes their programs are less than satisfactory and have not been used by many businesses. Therefore, SBA and Eximbank jointly initiated a one year study to rejuvenate their export working capital financing programs. As a result of the study, they started a joint one year pilot program on October 1, 1994. The officials of both agencies hope that this pilot program will be more user friendly and accepted more widely by the business community.

Less than half of the 50 states offer export working capital financing. JEDA's program is unique in that it the only program which is not supported by state appropriated dollars. It was the creditability of the JEDA international staff that provided private commercial banks the confidence necessary to provide a credit facility for domestic lending which included export financing. With the exception of California, most states have only one full-time staff member promoting international financing programs. Due to the unique nature of export financing, the participating states do no more than three to five deals per year on the average.

9 The Palmetto Basic Building Program was created as a marketing tool to attract businesses/companies to rural, economically distressed areas affected by Hurricane Hugo not for job creation. The job creation requirement was instituted by a change in HUD regulations subsequent to the beginning of the Program. JEDA has, at no time, been out of compliance with satisfying either of the HUD National Objectives. Incidentally, three of the six buildings constructed were done so in economically distressed areas and 50 people are now gainfully employed as a result of this Program. Buildings have been constructed in such areas as Lancaster, Marion, Darlington and Chester. **(SEE EXHIBIT III)**

10 In each of the four(4) cases the LAC cited all available collateral and practical personal guarantees were obtained. While these losses are undesirable, one must keep in mind that economic development goals are not always consistent with loan underwriting.

<u>Loan #1:</u> The Borrower was a dyeing and finishing company. $1.9 million was outstanding from this company prior to this loan being made. In 1987, this loan was made and the two preceding loans were refinanced at the request of the Governor, a resident member of the General Assembly, and city and county officials. The overall funding package strengthened the collateral position of the credit. The former operator of the facility, a large textile company, provided the company with collateral incentives, as a result of the Governor's involvement. While the project was undercollateralized, the commitment also helped the town ensure the solvency of its water system. This funding also provided 220 jobs in a rural community for more than two years.

<u>Loan #2:</u> This loan was made to a textile company. The request for assistance was made by the Governor and the State Development Board. The rationale for this loan focused on protecting 1,800 jobs in <u>13 rural communities in South Carolina</u>. This credit was based on orders the company had, and was secured by inventory. The borrower closed their operation for credit reasons and abandoned the collateral to JEDA and, as a result, the inventory was sold at a deep discount. After discounting the merchandise and commissions paid, an $85K loss resulted. This transaction was risky, however, worth the risk in an effort to protect over 1,800 South Carolina jobs. Although adequate collateral was obtained at the time the loan was made, some inventory was sold at a discount, and a commission had to be paid to sell the inventory, JEDA recaptured almost 90% of its investment. The company was a publicly traded company and no personal guaranties were available. **Exhibit I** illustrates the impact JEDA's assistance made to the state.

<u>Loan #3:</u> This loan was an agribusiness loan. The State Development Board and the State Department of Agriculture asked for our assistance in attracting this company to South Carolina. Our research indicated that the president was dismissed because of his inability to manage the operation and not for European drug-related crimes, for which he was fully pardoned. Because the potential guarantor resided in Guatemala it was not practical to obtain his guarantee. JEDA did not influence any law changes as the LAC suggests. JEDA is a self-sufficient, free-enterprise agency of the state and is always concerned about any losses incurred by the state. However, since JEDA does not promulgate this legislative policy, it cannot be held responsible for the loss of revenues to the state as cited in the LAC report.

<u>Loan #4:</u> The Borrower on this transaction was a wood specialty company. The Board member conveyed his property because he was a concerned citizen who believed he was acting in the best interest of his community. The records document that he did not profit from pledging his land in support of this project. JEDA agrees that this loan was undercollateralized, however, all available collateral was obtained. This was a loan to a business in a rural community that would create 35 jobs. Approximately twenty (20) people were employed for 15-18 months before the business closed.

11 CCIC, as a credit facility, is different from JEDA and is funded, in part, by four major financial institutions in South Carolina. At local community banks, funding under a facility of this nature, sometimes is utilized by the borrower at the 100% level. CCIC on occasion, after exercising due diligence, will fund transactions similar to local community banks.

12 **There was not an inappropriate use of loan proceeds in the referenced loan.** This statement refers to a loan made to an entrepreneur to assist in acquiring the stock of a radio station. The loan proceeds allowed the present owner to purchase the stock of the radio station and, in essence, gain control of the enterprise. This loan facilitated minority ownership in an under-represented industry.

JEDA's conflict of interest policy has been strengthened effective May 18, 1995.

13 This is not a violation of state law. A formal opinion from legal counsel clarifies this question. The $583,000 in question were monies paid by JEDA to CCIC for certain administrative expenses pursuant to the management contract between these parties and further, these payments were made per the receipt of proper invoices from CCIC. **(SEE EXHIBIT IV)**

The agency had fiscal audits performed by Wilkes & Company, CPA, in the years in question and no findings were noted.

14 <u>Administrative Charges</u> - The maturing of JEDA and CCIC has been the result of constant transitioning and learning. We have revisited our methods of calculating administrative recovery rates and taken corrective action where needed. CCIC has reimbursed JEDA for all administrative cost over recovery and loan servicing cost over recovery through June 30, 1994. The fee rates for FY94-95 have been adjusted periodically to insure proper cost recovery by year end.

Payment of Fees (page 42) - The decision to leave the $161,000 servicing fee with JEDA, relative to the IDB Program, was made by the Chief Executive Officer with the full knowledge of the JEDA and CCIC Boards of Directors; however, this decision was not reflected in a modification of the Service Contract. Any future changes to the management agreement will be made in writing.

Because of JEDA's expertise in the commercial lending area, the Division of Economic Development in the Governor's Office contracted with JEDA to administer the Minority Loan Program (MLP). This included, but was not limited to underwriting, marketing, credit evaluation, servicing, collection and any other duties as related to the MLP. For these services a contract was negotiated and a flat fee of $75,000 authorized to be paid JEDA. This included the administration of any and all loans made under this program for a two year period. This contractual arrangement is very similar to that used in JEDA's relationship with the SCANA Revolving Loan Fund and Savannah Lakes Revolving Loan Fund, in that, JEDA was paid a flat fee for its services, rather than an amount based on cost recovery.

Once there is demonstrated income in the PBBF Program appropriate adjustments will be made.

The Department of Commerce is in the midst of developing a Strategic Plan which hopefully will address what capital gaps exist in South Carolina. The Secretary of Commerce has been very clear with respect to JEDA's critical role in addressing the capital gaps as we now define them. JEDA should continue to be an independent agency. This independence allows JEDA to make sound lending decisions without direct political influence and at the same time, be a strong team member in the overall statewide economic development effort for South Carolina.

MAJOR RECOMMENDATIONS (Page vii)

15 This assumption is fallacious, JEDA has and continues to work very closely with the Department of Commerce and other statewide and local development entities.

JEDA created statewide economic development initiatives as part of its pro-active approach and in doing so developed a composite industrial development bond program which was among the first in the nation and coordinated with HUD to close the first asset securitization transaction in the nation using CDBG loans. It also assisted the Governor's Office in closing some of the first transactions in the country involving State participation in HUD's Section 108 program.

16 This implies that the two Boards made up of outstanding citizens of South Carolina, eight (8) of whom are appointed by the Governor, do not have the time nor the talent to properly oversee both JEDA and CCIC.

17 The Division of Economic Development, unlike JEDA and CCIC, is not involved in the intricate business of lending nor the administration of a substantial portfolio.

18 The Main Street Investment Program was not designed specifically for economic development, rather, to streamline the process of SBA loans less than $100,000. While South Carolina has made great strides during the twelve (12) years of JEDA's existence, there is nothing to suggest that the concerns the General Assembly had in 1983 about the state's ranking in per capita income, poverty rates, unemployment, high school graduation rates, welfare recipients, infant mortality and similar indices of economic and social well being placing our State at or near the bottom of the heap have changed.

19 The State of Kentucky like the states of Massachusetts, New Jersey, Illinois, Maine, Connecticut and Maryland, all are a part of a respective Commerce Department, and have separate autonomous Boards which are responsible for the day to day activities and thereby provide the necessary safeguards between the marketing arm for economic development and the financing arm for economic development.

RESPONSE TO LAC RECOMMENDATIONS (PAGE 7 - 60)

1• As mentioned in the Executive Summary JEDA is in the process of documenting its established job creation procedures, however, JEDA contends that the percentage between created and retained jobs is immaterial since the economic impact is the same.

• **Exhibit I** illustrates that while a company may no longer have employees, the existence of these jobs at one period in time contributed materially to the economic benefit to the state. For this reason JEDA believes it is not necessary to categorize jobs attributable to charged off loans.

• We count those jobs that are CDBG related, however, we have no control over what other lenders report. JEDA is responsible only for its own reporting to satisfy its loan requirements. The LAC is again criticizing a loan previously cited in its report giving the reader the impression that each critique is for a different loan.

2 JEDA only counts those jobs which are directly related to its loan(s). If JEDA makes a loan to a start up company that subsequently expands its operations, JEDA will claim those expansion jobs as well. Since these are start up situations, private lender financing is very limited. Had JEDA not loaned its resources, the company more than likely would not have started and the multiple plant site jobs would not have been created. Thus JEDA feels justified in claiming credit for these jobs. Only jobs in South Carolina are counted. The company on which the LAC based this criticism, opened plant sites in numerous distressed rural communities.

3 This is a moot point since JEDA performs a monitoring visit to the client business semi-annually and this information is obtained during these visits.

4 See Executive Summary **item #2 (SEE EXHIBIT IV)**

5• JEDA/CCIC will not provide technical and managerial assistance based on recommendations from legal counsel regarding lender liability.

• JEDA's loan policy clearly states that Loan Administration is not responsible for administering problem loans, but the actual Account Officer assigned to the credit. ***"Throughout the life of the credit, loan officer and loan administration personnel conduct periodic on-site visits with borrowers. These visits provide information essential to managing the credit and serve to keep JEDA current on all aspects of the business."*** Also, JEDA and CCIC have developed a policy for troubled assets, namely, an Asset Quality Rating System and the corresponding report. The report identifies problem loans and steps to be implemented in an attempt to cure the problem.

6 JEDA as a state agency, clearly understands the constitutional constraints of ownership in a private company. CCIC, as a non-state entity, is not bound by these same constitutional constraints.

7 JEDA establishes, to the contrary, goals and performance measures each year. They are established by the staff, presented to and approved by the Board of Directors each year.

8 This data is collected during each semi-annual monitoring visit.

9,10 JEDA notes this with great interest and will examine the feasibility of this recommendation.

11 This information is gathered on each semi annual monitoring visit.

12 JEDA has often served as a catalyst by stimulating the private sector to develop below market financing alternatives. For example, when JEDA initiated its composite bond program, South Carolina banks did not provide letters of credit for long-term project financing. These fees and banking relationships went to out-of-state banks. After one to two years of promoting its program, JEDA introduced South Carolina's three largest banks to this form of financing. Today, each of these banks has developed a strong "lower floater" industrial development bond program based upon their letters of credit. While the banks may have eventually developed these programs on their own, they most certainly would not have done so until years later than they actually did. While JEDA still has this product available, the market determines its use.

13 JEDA has assisted in numerous health care financings. The job impact from these projects is quite substantial having created 9,108 jobs. Moreover, JEDA's participation saves money for local governments by allowing them to retain their "small issuer" status, which allows local governments to designate bonds for county projects as "bank qualified." This status reduces the interest costs which local governments must pay on their projects. Elder care is a growing trend in the state and investment in this area is in the best interest of the state. Participating in healthcare bond issues further diversifies loan activities and is viewed as critical to improving the quality of life for South Carolina and its citizens. **(SEE Exhibit V)**

14 As stated in the Executive Summary, JEDA is providing these international services.

15 We disagree with the recommendation of the Legislative Audit Council (LAC) regarding measuring the performance of the export program. JEDA does agree to the need for better collection of data to evaluate its international program offerings. It is our intention to consult with the National Association of State Development Agencies (NASDA) and evaluate the key performance measures utilized by states with active export finance programs. Our disagreement with LAC's recommendation is found in the all important cost benefit area.

16 See Executive Summary Item #4

17 The purpose of the Program is to stimulate economic development through speculative buildings which can act as a catalyst to attract prospects to the respective community. For that reason, JEDA does not focus on the Local Development Corporation's limited assets other than the land pledged in support of the project.

18 JEDA's lending policy states that loans will not be made to businesses with a net worth of $1,000,000 or more. Under prudent credit standards JEDA looks for a secondary source of repayment in financially strong guarantors. A strong guarantor can minimize the loss of scarce monetary resources. Therefore JEDA does not preclude these types of guarantors.

19 It is the practice of JEDA and CCIC to follow strictly the directions as articulated in the lending policies in the loan policy developed in 1987 and subsequently amended in 1992. Personal Guaranties as is stated in the lending policy "**may** be required." This is a requirement unique to every credit.

20 CCIC is not a gap lender. Therefore, 100% financing is authorized in certain circumstances.

It is clear that the LAC's interpretation of CCIC's bylaws is incorrect. This language refers to stimulating investments in the state by new and/or expanding businesses.

21 JEDA has always ensured that loan proceeds are used in accordance with statutory requirements and has never violated these statutes as LAC alleges.

22,23 Both JEDA and CCIC have amended the by-laws prohibiting loan consideration for staff members and their immediate families. Board action taken on May 18, 1995.

24-27 See Executive Summary item #13 **(SEE Exhibit IV)**

28,29 JEDA has and continues to periodically review its administrative charges for the CDBG program to ensure that they are appropriate and correct. Furthermore, CCIC has reimbursed the CDBG revolving loan fund for all administrative overcharges.

30 With respect to the Minority Loan Program, it should be noted that JEDA entered into a "one time" contractual relationship with the Governor's Office. Specifically discussed in the Executive Summary **item #14.**

31 The decision to leave the $161,000 servicing fee with JEDA, related to IDB Program was made by the Chief Executive Officer with the full knowledge of the JEDA and CCIC Boards of Directors; however, this decision was not reflected in a modification of the Service Contract. The respective Boards will formalize the amendment at its next Board meeting.

32 Any future changes to the management agreement will be made in writing.

33 Four items were listed by the LAC under Miscellaneous Expenditures the LAC stated as unnecessary and wasteful purchases. However, before listing the items, they stated that none of the expenditures broke any laws, state requirements, or policies. In order to elevate the services and visibility of JEDA's programs, JEDA must function as any other private sector business which includes modest business development and entertainment expenses, compensating staff in an appropriate manner, and allowing non-paid Board members the opportunity of visiting with other economic development people in the state and viewing projects where JEDA has made a loan investment.

34 The RFP process was conducted in accordance with all proper procurement rules and regulations.

35 According to the interpretation provided by the Secretary of State's Office on lobbying expenses at that time there was no violation of state laws. Per the interpretation, it was our understanding at that time only the actual time spent lobbying members of the General Assembly or other public officials regarding the passage of law were reportable as "lobbying expenses." All invoices were structured in the manner described above and throughout the term of this relationship, it our contention that all expenses were reported properly.

36 JEDA will consider the development of relevant criteria for Loan Administrators (Loan Servicing).

37 Historically, JEDA and CCIC have conducted internal desk audits of the loan portfolio files in order to identify possible problem areas. As a result of these desk audits, corrections were made to those files where appropriate. It is CCIC's intention to create a position for a Loan Review Officer in FY 95-96.

By employing an experienced credit person as a Loan Review Officer, JEDA and CCIC will ensure that all loans/bonds files will be in full compliance with policy.

A further quality control measure exists because the four lenders which provide the funding perform an analysis of the credit. Their analysis determines if the transaction meets established standards and can be funded from CCIC's line of credit.

38 The handling of all seized assets is performed by a specific officer. However, further refinements have been made relative to accounting controls to assure that all seized assets are properly accounted for and safeguarded.

Also, it should be noted that the final independent auditor's report dated November 1, 1994, did not include any mention of JEDA lacking accounting controls over foreclosure action, as stated in the LAC report.

39 As responded previously and demonstrated to the LAC, JEDA currently provides information as to which loans were sold as a part of the Asset Securitization Transaction and maintains a "MAST" portfolio of same.

40 CCIC was established pursuant to Section 41-43-240 which clearly defines that any corporation established by JEDA, whether for profit or not for profit, is deemed to be a public corporation. Therefore, consistent with Section 30-1-10 to 30-1-140 (Title 30, Chapter 1) CCIC has and will continue to adhere to the Retention Policies for Public Records, Reports and Official Documents.

Currently, CCIC's policy mirrors JEDA's retention schedules. This has historically been acceptable to Archives. However, verification of this procedures was requested from the State Records Center/SC Department of Archives and History. As a result of this request, an update of JEDA's records retention schedules is in progress and CCIC is developing separate schedules.

41 In the future efforts will be made to be in full compliance of the law.

42 JEDA will provide written notices of all meetings of the Board of Directors including Committees and Subcommittees consistent with the SC Code Anno. §41-43-80. **(SEE Exhibit IV)**

43 A formal written investment policy is currently in the process. It was management's decision, with the consent of the Board, to maintain a conservative stance regarding investment of funds. The need for ready availability of funds dictated our policy of investing in short term instruments. Historically, CCIC has invested in short term CD's and currently has all major accounts in overnight government security "sweep" accounts where earnings are equivalent to those offered through CD's. However, a formal written investment policy is currently in the process of being developed and will be presented to the Board of Directors for approval upon completion.

44 Management periodically reviews all deposit accounts and recommends closing accounts when appropriate.

45 Historically, CCIC has invested in short term CD's and currently has all major accounts in overnight government security "sweep" accounts where earnings are equal to or exceed those of the State Treasurer's Office Investment Pool. However, a formal written investment policy is currently in the process of being developed and will be presented to the Board of Directors for approval upon completion.

46 The Department of Commerce is in the midst of developing a Strategic Plan which hopefully will address what capital gaps exist in South Carolina. The Secretary of Commerce has been very clear with respect to JEDA's critical role in addressing the capital gaps as we now define them.

47 JEDA presently is a part of a Committee which includes the Budget and Control Board, the Governor's Office, and the Department of Commerce in reviewing the usage of Tax-Exempt bonds and the wisdom of setting priorities as to how and to whom these bonds should be allocated.

NOTE: *Please note that the Legislative Audit Council's space restrictions would not allow the necessary space for publication of all the Exhibits used in response to the entire audit. JEDA will make these Exhibits available to interested parties.*

EXHIBIT I

When one considers all the circumstances and effects JEDA's assistance generates, one can more clearly understand its role. For instance, review the facts of the loan to the company whose 1,583 jobs were retained for 6 months through JEDA's assistance. Payroll information was gathered from company supplied information.

a.	Average weekly payroll for 1,583 employees:	$399,892.31
b.	Number of weeks jobs retained:	26
c.	Total payroll for 26 weeks:	$10,397,200.06

If each employee filed a tax return on the average wage ($11,043.23 per year) paid over 6 months, the following would be true (assume standard deduction and exemption):

a.	Average income for 6 months:	$5,521.62
b.	Less standard deduction and exemption (1/2 year)	<3,000.00>
c.	Taxable Income	$2,521.62
d.	X SC Income Tax Rate	7%
e.	Estimated SC income tax realized per employee	$176.51
f.	Total estimated SC income tax realized for 1,583 employees	$332,368.33

In addition to the income tax the State received due to JEDA's assistance, the company's employees avoided unemployment compensation. Considering that 13 rural areas where affected by this company, it is likely that finding a new job would take longer than if the company was located in an urban environment. Nonetheless, in order to provide a conservative estimate of the savings to the State, JEDA has assumed that the average unemployment benefit will be $100 per person. Additionally, it is estimated that the average duration of benefit receipts will be 13 weeks (half of the maximum). It is also assumed that only 10% of the employees would receive unemployment compensation.

a.	Estimated number of weeks to receive unemployment compensation:	13
b.	Estimated weekly benefits:	$100.00
c.	Aggregate estimated amount of unemployment benefits saved: (188 employees X $100.00 X 13 weeks)	$244,400.00

In that 1,163 of the 1,583 employees, or 62% of the work force, were low to moderate income individuals, it is likely that many of those families would seek AFDC (Aid to Families with Dependent Children) while being unemployed. JEDA has assumed that 10% of the LMI individuals would receive these benefits. Therefore, JEDA's loan had an additional estimated savings to the State as detailed below:

a.	Estimated number of weeks to receive AFDC:	13
b.	Estimated weekly benefits:	$100.00
c.	Aggregate estimated amount of AFDC saved: (116 employees X $100.00 X 13 weeks)	$150,800.00

The following must also be considered:

a.	Loan amount:	$500,000.00
b.	Recovery amount (approximate):	$415,000.00
c.	Net charge off (approximate):	$85,000.00

To determine the entire benefit to the State, consider the following:

Income tax realized:	$ 332,368.33
+ Unemployment benefits saved	$ 244,400.00
+ AFDC Saved	$ 150,800.00
- Net charge off	$ 85,000.00
NET SAVINGS TO STATE	$ 642,568.33

Even if JEDA had not performed due diligence in its underwriting and subsequently charged off the entire loan amount, the net savings to the State would still be substantial.

EXHIBIT II

SC Jobs—Economic Development Authority

CDBG Activity By Historically Distressed Counties From 1983–1992

County	Total Unemployed	Total Labor Force	% of State Total	Number of Loans %	Dollars of Loans %	Number of Loans %	Dollars of Loans %
Abbeville	770	11,350	0.64%	4	1,050,000	2.63%	2.42%
Allendale	510	5,720	0.32%	1	140,000	0.66%	0.32%
Bamberg	640	6,790	0.38%	2	362,000	1.32%	0.84%
Barnwell	1,140	9,180	0.52%	1	500,000	0.66%	1.15%
Chester	1,630	14,400	0.81%	4	1,429,839	2.63%	3.30%
Clarendon	1,220	11,910	0.67%	5	1,417,500	3.29%	3.27%
Colleton	1,470	18,430	1.04%	1	400,000	0.66%	0.92%
Darlington	2,670	30,150	1.70%	3	505,000	1.97%	1.17%
Dillon	1,280	13,850	0.78%	1	250,000	0.66%	0.58%
Fairfield	940	10,260	0.58%	2	154,400	1.32%	0.36%
Georgetown	2,000	22,970	1.30%	5	1,495,723	3.29%	3.45%
Hampton	630	7,430	0.42%	3	950,000	1.97%	2.19%
Jasper	430	6,600	0.37%	4	990,600	2.63%	2.29%
Lee	680	9,320	0.53%			0.00%	0.00%
Marion	1,780	15,290	0.86%	3	898,750	1.97%	2.07%
Marlboro	1,140	12,020	0.68%	2	1,000,000	1.32%	2.31%
McCormick	310	3,230	0.18%			0.00%	0.00%
Orangeburg	3,390	41,020	2.31%	10	2,631,994	6.58%	6.07%
Sumter	3,190	39,650	2.24%	3	1,500,000	1.97%	3.46%
Union	1,190	14,670	0.83%	11	1,559,000	7.24%	3.60%
Williamsburg	1,400	17,300	0.98%	7	2,037,500	4.61%	4.70%
Total	28,410	321,540	18.13%	72	19,272,306	47.37%	44.46%
State Totals	111030	1773120	100.00%	152	43,346,949	100.00%	100.00%

Sources of information: "South Carolina's Labor Force and Industry 1988–1992" by SC Employment Security Commission; "Lending Summary" dated December 31, 1992 by JEDA; historically distressed counties as determined by JEDA with Board of Directors approval.

EXHIBIT 111

OMEGA
POLYMER TECHNOLOGIES INC

1331 SOUTH CHILLICOTHE ROAD · AURORA, OHIO 44202-9218 · TEL.: (216) 562-5201 · FAX: (216) 562-7452

Thomas E. Deller
President and CEO

March 20, 1995

Fax Message: 803/737-0016

Mr. Elliott E. Franks, III, CEO
South Carolina Job Economic Development Authority
1201 Main Street, Suite 1750
Columbia, SC 29201

Dear Elliott:

We wanted to drop you a note to thank you for your efforts on our behalf which resulted in our bringing Carsonite International Corporation to the Hampton County area. The JEDA Spec Building Program was critical in our decision regarding the location of Carsonite International Corporation. We expect that within a relatively short period of time the facility will have approximately ninety (90) full-time employees and hope to grow beyond that in the future.

Thanks again and congratulations on such a farsighted program.

Very truly yours,

Thomas E. Deller
President & CEO

TED:jec

NEXSEN PRUET JACOBS & POLLARD, LLP
ATTORNEYS AND COUNSELORS AT LAW

W. THOMAS LAVENDER, JR.
PARTNER

DIRECT DIAL
803-253-8233

June 1, 1995

Reply to Columbia

Elliott E. Franks, III, Executive Director
South Carolina Jobs-Economic Development Authority
1201 Main Street, Suite 1750
Columbia, South Carolina 29201

Dear Mr. Franks:

At your request, we have reviewed selected portions of the April 1995 South Carolina Legislative Audit Council's Report to the General Assembly entitled "A Management and Performance Review of the South Carolina Jobs-Economic Development Authority" (the "Review"). Specifically, you have asked that we respond to three (3) alleged deficiencies concerning the agency's operations as set forth in the Review. Each alleged deficiency will be discussed below.

1. Loan Committee.

The Review suggests that the South Carolina Jobs-Economic Development Authority's (the "Authority") practice of allowing a committee of the board of directors, as well as certain loan officers, to approve loans is a violation of S.C. Code Anno. § 41-43-10, et seq. (Lawyers Co-op. 1993)(the "Act") and the Authority's bylaws. (Review p. 12). The Review cites S.C. Code Anno. § 41-43-60 of the Act which states that a majority vote of the directors in office is required to take action.

While no express authority is granted in the Act for the board of directors to delegate any of the board's authority to a committee of the board, S.C. Code Anno. § 41-43-90 of the Act states that the Authority (not the board) is a:

> "public body, politic and corporate, and an agency of the State and may: (A) Adopt bylaws, procedures, and regulations for the directors, officers, and the employees and for the implementation and operation of the programs authorized by this act." (emphasis added).

The Authority pursuant to Article III, Section 1 of the Authority's bylaws has authorized the establishment of a Loan Committee.

133372.1-LT (WTL) 012783-?

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CHARLESTON OFFICE
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GREENVILLE OFFICE
1000 EAST NORTH STREET, 2ND FLOOR (29601)
POST OFFICE DRAWER 10648, GREENVILLE, SC 29603
803-370-2211 ■ FAX 803-282-1177

The general corporate law permits a board of directors, if permitted in the corporation's articles of incorporation or bylaws, to delegate certain authority of the board of directors to committees established by the board. Corporations, as well as agencies of the State are guided by policy established by its board of directors and implemented by its officers and employees. Although the bylaws do not expressly authorize the Loan Committee to approve loans, only that such committee be formed, the Act provides that the Authority, not the board of directors, may make loans. Although it would be preferable that the bylaws expressly authorize the Loan Committee to approve the loans, the board of directors has continuously ratified the actions of the Loan Committee, thus confirming the intent of the board of directors.

Furthermore, a practical analysis would lead one to conclude that the Loan Committee could be formed to approve the Authority's loans. The Review suggests that the Authority may only act upon a majority vote of the board of directors. Taking this argument literally, all decisions of the Authority, including the purchase of supplies and other routine office decisions, would require the approval of the directors. Clearly, such an interpretation of the Act would lead to an unworkable management structure. The Review fails to recognize the distinction between the Authority and the board of directors. The Act prescribes the powers of the Authority, not the board of directors. The Authority, not merely the board of directors, is authorized to make loans and grants. Although the policies of the Authority may be established by the board of directors, this does not expressly limit the powers of the Authority to those specified by the board. Consequently, there is no specific statutory requirement that grants and loans be approved by the full board of directors.

Attention is also called to S.C. Code Anno. § 41-43-60 which states that the board must meet at least one time each calendar quarter. Meeting so infrequently prohibits the board from being available to address and approve each loan made by the Authority. In such event, someone or some group must have the power to carry on the Authority's business between board meetings. In this instance, the Loan Committee reviews and approves all loans greater than $50,000 and allows other loans to be approved by duly appointed loan officers. This procedure is consistent with financial practices of corporate lending institutions and is not inconsistent with the Authority's enabling legislation.

2. Payments to Not-For-Profit.

The Review questions the Authority's payment of funds to Carolina Capital Investment Corporation ("CCIC"), a not-for-profit related entity of the Authority, which then loans the funds to borrowers. (Review page 40). The Review states that the "transfer" of such funds is a violation of S.C. Code Anno. § 41-43-220, which provides that only administrative expenses be payable out of administrative funds.

It is our understanding that these funds were appropriated to the Authority as "administrative funds" and that payments were made to CCIC as compensation for "administrative expenses" pursuant to the management contract between the parties and that these payments were made periodically upon receipt of proper invoices from CCIC. To the contrary, you advise that such funds were not "transferred" to CCIC as a lump sum into its "revolving loan fund" as implied in the Review. Based upon this information, it appears that the use of such funds in this manner was for the payment of legitimate administrative expenses, and, therefore, not in direct violation of the Act as the Review suggests.

3. Freedom of Information Act.

The Review criticizes the Authority's failure to disclose the minutes of the Loan Committee under the Freedom of Information Act, S.C. Code Anno. § 30-4-80 ("FOIA"). (Review page 52). It appears from our review of the FOIA that the definition of "public body" includes the Authority's board of directors and any committees and subcommittees of the board of directors. S.C. Code Anno. § 30-4-20(a). As a consequence, written notice of all meetings of the board of directors, including committees and subcommittees of the board of directors, must be given in the manner provided by S.C. Code Anno. § 41-43-80.

I hope that this letter has adequately addressed your questions. If you need anything further, please do not hesitate to contact me.

Very truly yours,

Tommy Lavender

W. Thomas Lavender, Jr.

WTLjr:tbp

133372.1-LT (WTL) 012783-3

EXHIBIT V

HENRY B. RICHARDSON, JR.
COUNTY ATTORNEY

Sumter County

Sumter, South Carolina
29150

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775-1365

May 31, 1995

Mr. Elliott E. Franks, III
Executive Director
South Carolina Jobs-Economic
Development Authority
FAX (803) 737-0016 VIA FAX
1201 Main Street, Suite 1750
Columbia, S. C. 29201

Re: ISSUANCE OF HOSPITAL BONDS BY JEDA

Dear Mr. Franks:

Sumter County benefits from the South Carolina Jobs-Economic Development Authority's ability to issue bonds for 501(c)(3) hospitals. If Tuomey Regional Medical Center is restricted to issuing bonds through Sumter County, Sumter County will be precluded from taking advance of Section 265 of the Internal Revenue Code.

This section allows the County to sell bonds and enter into equipment lease purchase agreements at more attractive rates. To take advantage of Section 265, the County must keep all of its borrowings under $10,000,000. Bonds issued for 501(c)(3) organizations such as Tuomey Regional Medical Center count against our $10,000,000 limit.

With kindest personal regards, I remain

Yours very truly,

Henry B. Richardson, Jr.

Henry B. Richardson, Jr.

HBRjr:bj
Enclosures
CC: Mr. William T. Noonan
County Administrator
Sumter County Courthouse
141 North Main Street
Sumter, S. C. 29150

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